The Least Developed Countries and World Trade – Second Edition

STEFAN DE VYLDER

Fifty different countries all over the world have been designated as Least Developed Countries (*LDC*s) by the United Nations. This study examines the role that trade can play in the development of these countries. The importance of the various agreements concluded within the *WTO* is discussed. What is the bottom line as far as trade agreements with the European Union are concerned? How do other bilateral or regional agreements function? How do trade barriers operate? What is necessary for a country to be able to operate successful trade activities?

The author interlinks the internal and external factors which affect *LDC*s' opportunities of participating in trade and growth in a global scenario and examines trade as a part of the wider development complex.

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STEFAN DE VYLDER

Sida*studies*

Foreword by Sida

Active participation in international trade contributes to economic growth which, in turn, is an important prerequisite for sustainable poverty reduction. Many developing countries have been able to benefit from globalisation and worldwide trade liberalisation and have consequently managed to increase their participation in world trade and reduce their poverty levels. The Least Developed Countries (LDCs), with over ten per cent of the world's population but only 0.5 per cent of global exports have, however, become increasingly marginalised in the world economy during the past few decades.

The overall goal of Swedish development cooperation is to contribute to the creation of conditions that will improve the standard of living for people in developing countries. Sida's support in the area of trade therefore aims at assisting developing countries to integrate into the world economy in a manner that enables them to benefit from trade and to promote sustainable, poverty-reducing growth. To achieve this, Sida will:

- support developing countries' capacity to design and manage their trade policy framework
- support developing countries' capacity to effectively participate in bilateral, regional and multilateral trade policy making
- support developing countries' capacity to trade by implementing agreed trade rules and enhancing their capacity to meet the standards of the export markets, and consequently increase their own exports.

In order to contribute to increased knowledge and to stimulate debate and dialogue concerning the situation of the least developed countries in the world trade system, Sida published a report in its series "Sida Studies" in 2001 entitled "The Least Developed Countries and World Trade" by Stefan de Vylder, Gunnel Axelsson-Nycander and Marianne Laanatza. This study was well received and has, for example, been widely used as a textbook by academic institutions in Sweden and in developing countries. However, much has happened in the area of trade policy since 2001 and as the study is continuously in demand (as witnessed by several reprints) Stefan de Vylder was commissioned by Sida in 2006 to revise and update the study in consultation with the other two authors of the 2001 edition.

The study approaches the problem from the situation experienced by the least developed countries and provides a multi-facetted analysis of world trade and development opportunities. The opinions stated in this study belong to its authors – the problem belongs to us all.

January 2007

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Executive Summary

The LDCs: poor and marginalised

Of the 50 countries classified by the UN as LDCs (Least Developed Countries) the majority, or 34, are found in sub-Saharan Africa.

Around 750 million people live in LDCs or 11.5 per cent of the entire world population. Their share of world GDP, however, amounts to no more than 0.6 per cent.

Forty five per cent of the LDC population are estimated to be living in extreme poverty and 75 per cent have an average income of less than two US dollars per day. Life expectancy is only 52 years, as against an average of 65 years in developing countries as a whole.

The LDCs have been successively marginalised in the global economy. Their share of world trade has shrunk from over one per cent twenty years ago to around 0.5 per cent today. Two LDCs – Bangladesh (garments) and Angola (oil) account for over one fourth of all LDC exports.

The LDCs' share of all foreign direct investment (FDI) to developing countries is a mere 1.5 per cent, and of the small amount of FDI going to LDCs, over 70 per cent went to a small number of oil and mineral exporting LDCs.

To a certain extent, economic stagnation in LDCs can be traced to external factors such as falling terms of trade, shrinking foreign aid and trade barriers on export markets. However the dominant reasons are of an internal nature and are related to the extreme poverty and prevailing political climate in these countries: lack of education, inadequate physical infrastructure, political instability and civil strife, poorly developed democratic traditions and institutions, in many cases also corruption and abuse of power.

The HIV/AIDS disaster has also exacerbated poverty. In many African LDCs, HIV/AIDS has already dramatically reduced average life expectancy and the human, social and economic costs will be vast in the coming decades.

Dynamic benefits of foreign trade

Foreign trade is a necessity for all countries, rich or poor. Isolation is not an option and the benefits of foreign trade are potentially huge, not least for the least developed countries.

The dynamic benefits of foreign trade include

- trade enables *economies of scale*. This is of critical importance for the very poorest developing nations where local markets are too small to provide an adequate platform for the development of domestic production.
- trade can create *increased competition*. Companies are forced to become competitive on export markets, and external competition is often needed on protected domestic markets in order to increase productivity and force down monopoly prices.
- trade can play a key role in facilitating the *transfer and spread of new technology*. We use the term technology in its broadest meaning to include also new management principles, marketing know-how, new ideas and impulses, etc.
- openness to trade may also have beneficial *policy effects*, for example by creating incentives for governments to pursue less distortionary domestic policies and more disciplined macroeconomic policies.

However, greater integration with the world market does not automatically lead to prosperity. The benefits of trade can be very unevenly distributed, and there are also risks attached – risks of unemployment, increased vulnerability, lower levels of food security, exhaustion of natural resources etc. – which the very poorest nations must be especially aware of.

The LDCs, WTO and trade policies

The LDCs play a marginal, albeit increasing, role in the new world trade organisation, the WTO, and in the global regulatory framework that is under development. Over one third of all LDCs are not members of the WTO, and most of those who are members are only very sporadically involved in WTO trade policy negotiations.

One reason why the LDCs are not more actively involved in WTO is a lack of resources, mainly in the form of trade policy expertise. The industrialised countries have an enormous advantage in this respect.

Another reason is that most LDCs have joined various bilateral preferential trade arrangements – for instance with the EU – that tend to be of greater importance for market access than WTO. Part of this study covers the various preferential arrangements with OECD countries and we also discuss the advantages and disadvantages of the current tendency to regionalisation, i.e. the formation of regional free trade areas, customs unions and other types of regional economic cooperation. We also throw light on the positive trends of South-South cooperation in the area of trade which is clearly discernible in various parts of the world.

The LDCs' lack of involvement with the WTO is also related to the fact that their development problems are due more to their supply constraints, that is to say, difficulties in producing something that is competitive on the world market, than issues concerning market access. Even so, the LDCs are also hampered by the trade barriers that still exist on other countries' markets.

The most serious of these trade barriers are the restrictions that remain in an area where the LDCs could be competitive today, i.e. agriculture. The promises concerning successive deregulation and increased market access made by the industrialised countries during the Uruguay Round of negotiations, which marked the formation of WTO, have not been fulfilled to any meaningful degree. The domestic agricultural sectors of many LDCs are also hard hit by dumping of food surpluses by rich countries, not least the EU, surpluses that are the result of heavy subsidies to agricultural production and exports.

Poorer countries are also hard hit by the tariff escalation which still characterises many imports to industrialised countries. Tariff escalation means that while raw materials are often imported duty-free, import tariffs rise with higher levels of processing. This tariff structure strikes at the root of any attempts by poorer countries to build up their own processing/refining industries based on their own raw materials.

The EU decision in 2001 to grant all LDCs duty-free access to the internal EU market for virtually all products is therefore extremely satisfactory. One factor which seriously dilutes the value of EU's promises of freedom from tariffs for LDCs is the complicated requirements surrounding rules of origin. These make it impossible for LDCs to gain advantage from the trade concessions if their exports consist of processed goods based on raw materials produced by developing countries which are not LDCs. One example could be that clothes exported from a LDC lose their tariff free status if they use cotton cloth from China.

A large part of this study addresses WTO agreements; their content and consequences for LDCs. It is claimed that even though the LDCs have been granted a series of exceptions and special rules – primarily in the form of extended transitional periods for implementing agreements – too little attention has been paid to the special circumstances and development needs in these countries.

Another central point is that many WTO agreements – such as TRIPS (regulates issues concerning intellectual property rights) and TRIMS (addresses investment issues) – are ill suited to LDC needs. The TRIPS Agreement in particular brings few advantages and many disadvantages for LDCs in the form of e.g. more expensive pharmaceuticals. We therefore consider that it is vital to allow the poorest countries, if they wish, to opt out of several new WTO agreements including TRIPS and TRIMS.

As concerns the new agreement on trade in services (GATS), negotiations are still at a very preliminary stage and it is too early to draw any conclusions as far as implications for LDCs are concerned. It is worth emphasising, however, that GATS in principle aims at covering all the vital social services including education, health care, communications etc. Consequently this agreement could have far-reaching consequences for both LDCs and industrialised countries.

Implementation of the various trade policy agreements is a costly exercise for the LDCs who lack much of the necessary expertise and infrastructure. These agreements are not only about reducing duties and other trade barriers, they also require far-reaching reforms of (and sometimes even the need to develop from scratch) national legislation and trade-related institutions. While import duties have been declining worldwide, non-tariff barriers to trade confronting developing country exports have become increasingly important. The TRIPS, the agreement on Sanitary and Phytosanitary measures and the agreement on customs valuations are examples of such demanding and costly agreements. Many LDCs choose therefore – often justifiably so – to reserve their scarce resources for use in other, more pressing areas.

Recommendations

Based on the conclusions we have drawn about WTO and other trade agreements from a low-income perspective, we wish to recommend:

- a successive but unconditional dismantling of industrialised countries' trade-distorting agricultural subsidies and a decrease of their import barriers;
- improved opportunities for LDCs to protect their domestic markets for foodstuffs;
- duty-free and quota-free market access to all OECD countries for all LDC products, and the maintenance of non-reciprocal trade preferences for developing countries;
- a reduction or complete elimination of OECD countries' tariff escalation and remaining tariff peaks vis-à-vis developing countries;

- a ban on anti-dumping measures aimed at LDCs, and a more restrictive application of the anti-dumping clause and other safeguard measures against developing countries in general;
- the introduction of harmonised and more generous rules of origin within bilateral trade agreements;
- a strong emphasis on development rather than free trade objectives in bilateral negotiations between LDCs and the European Union and the United States, and a rejection of the EU's attempts to include issues in their proposed Economic Partnership Agreements (EPAs) to which the developing countries have been opposed in WTO negotiations;
- that LDCs that so wish be granted greater policy space, i.e. more flexibility in the right to be exempted from certain rules and regulations (e.g. TRIPS or TRIMS, or parts of the Agriculture Agreement) which are not based on the development needs of the world's poorest countries;
- that direct costs to the LDCs of implementing the WTO agreements be reduced through increased and improved financial and technical assistance;
- support for institutional reforms in the WTO that increase the influence of poor countries in their negotiation process.

Introduction and acknowledgements

The original version of "The Least Developed Countries and World Trade" was written in early 2001. Unfortunately, the main conclusions from that study are not as outdated as I would have hoped.

The much publicised "Doha Development Round", which was launched at the WTO Ministerial Meeting in Doha, Quatar in October 2001, was greeted with considerable optimism within the developing world. The Doha Declaration, unanimously approved by the member countries, promised to put the needs of developing countries high on the agenda in future trade talks. Specific mention was made of the situation of the LDCS: "*We recognise the particular vulnerability of the least developed countries and the special structural difficulties they face in the global economy. We are committed to addressing the marginalisation of least developed countries in international trade and to improving their effective participation in the multilateral trading system.*"

Especially encouraging, from a development perspective, was the commitment by the industrialised countries to eliminate some of the most controversial elements of their trade policies. In particular, the Doha Declaration stated emphatically that, with regard to the much-disputed agricultural policies, the rich countries would undertake "*reductions of, with a view to phasing out, all forms of export subsidies*" and make "*substantial reductions in trade-distorting domestic support*" to agriculture. A number of other concessions to developing countries' demands were also made in areas such as intellectual property rights and in promises by the rich countries to improve market access by reducing tariffs peaks and tariff escalation affecting primarily exports from developing countries.

Doha raised expectations high. However, the lack of substantial progress on issues of special interest to developing countries at the next WTO Ministerial Meeting, in Cancún, Mexico in September 2003, caused collapse. The Cancún meeting witnessed the emergence of a strong alliance of middle and low-income countries who refused to continue negotiations unless earlier commitments from OECD countries were honoured.

While certain encouraging changes in the modalities of agricultural support in the European Union have been made in recent years, agriculture remains the key issue. The fact that the Ministerial Meeting in Hong Kong in mid-December 2005 failed to advance beyond a lukewarm compromise was largely due to failure to overcome the major stumbling-block: the rich countries´ continued unwillingness to make binding commitments to reduce their agriculture tariffs and subsidies. A number of larger developing countries, including India and Brazil, in turn refused to make corresponding commitments as regards reductions in their tariffs on industrial goods. Subsequent attempts to end the deadlock were in vain and in July 2006 the "Doha Development Round" was officially adjourned.

While most of the analysis of the difficulties that the least developed countries encountered in their domestic trade efforts, as well as in the world trade system, remains as valid today as six years ago, a number of events have occurred that make the 2001 edition of "The Least Developed Countries and World Trade" obsolete.

Among important developments which could not be included at the beginning of 2001 could be mentioned

- the rise and fall – or at least suspension – of the "Doha Development Round", which is discussed in several chapters but particularly in Chapter 15;
- the dismantling, in January 2005, of the old multi-fibre agreement regulating global trade in textiles and clothing (Chapter 9);
- the rising assertiveness of developing countries who have continued to insist on profound reforms of, among other things, the rich countries' trade-distorting agricultural policies (Chapter 10 and 15, in particular);
- the rise of China as a major player in international trade, and the impact of the "China factor" on global trade patterns and commodity prices (Chapter 1, 3 and 10);
- the gradual implementation of reforms of the agricultural policies of the European Union, in particular the decision to "decouple" most of its agricultural support from actual production levels (Chapter 10);
- the decision by the European Union to replace, over the coming years, its old preferential trade agreements with a large number of developing countries, including many LDCs, with the controversial Economic Partnership Agreements (EPAs) which are currently under negotiation (Chapter 13);
- the dramatic increase in bilateral and regional free trade agreements between industrialised and developing countries as well as within groups of developing countries (Chapter 14);
- the pronounced, and hopefully sustainable, recovery of economic growth in the LDC group in recent years (Chapter 1);

– the easing, thanks to domestic policy improvements, rising export prices and a number of multilateral and bilateral debt relief initiatives, of the foreign debt burden of a number of LDCs (Chapter 1 and 4).

The present study aims to cover these and other key events affecting global trade patterns and the regulatory framework governing international trade. The focus of attention remains the situation of the LDCs, with special emphasis on their development problems and needs, and on how they are affected by the multilateral trading system and by various bilateral trade agreements.

The major conclusions and recommendations (summarised in Chapter 16) are, by and large, the same as in 2001. The structure of the study has also been kept virtually intact, with one important exception: in the new edition, one chapter dealing with Swedish development cooperation in trade-related areas has been deleted.

While almost all sections in the present edition have been updated and/or revised, the author remains heavily indebted to the co-authors of the original study, Gunnel Axelsson-Nycander and Marianne Laanatza, whose contributions were and remain crucial. Gunnel and Marianne have also been kind enough to read a draft of the present study, and have provided extremely useful comments.

Valuable advice, criticism and facts have also been provided by, among others, Jens Andersson, Michael Herrmann, Joy Kategekwa, Rashid Kaukab, Elisabeth Löfvander, Tiyanjana Mphepo and Viviana Muñóz. Special thanks are due to Deniz Kellecioglu who has acted as my research assistant and who has provided both intellectual input and a wealth of figures necessary for the updating of the statistical tables.

While many friends and colleagues have contributed, the usual disclaimer applies: any errors or misunderstandings remaining are not their fault – only mine.

Stockholm, January 2007
Stefan de Vylder

Outline of the study

The aim of this study is to discuss the situation of the LDCs in the current globalised world economy. The emphasis is on trade issues and on the implications of the new regulatory framework that is emerging under the umbrella of the World Trade Organisation (WTO) for the poorest countries of the world.

In order to examine LDC participation in world trade and these countries' opportunities of benefiting from globalisation, we also aim the spotlight at internal development problems in LDCs as well as on debt and financing issues which affect their trade situation.

Chapter 1 provides a brief presentation of LDCs. Which countries are they? What does the LDC designation mean for a country? What are the advantages and disadvantages of LDC status?

The next chapter summarises modern international trade theory, with special emphasis on its relevance to the world's poorest countries from a dynamic, development perspective. We also attempt to establish which parts of trade theory that most economists currently agree on and the remaining disputed areas. The benefits of trade are well known, but are there also disadvantages and risks connected to trade liberalisation?

In Chapter 3, general development trends in the current world economy and world trade are described. The most important actors and driving forces in the globalisation process are discussed, as is the growing marginalisation of the LDCs. The LDCs' trade policies are described in the following chapter, including the extensive trade policy reforms which have taken place in most of these countries (Chapter 4).

While the economic stagnation of the LDC is, to a certain extent, related to external factors such as stagnating markets for their main export products, falling terms of trade, declining development assistance and the industrialised countries' harmful trade and agricultural policies, it must be acknowledged that the dominating causes are of an internal nature and are related to the profound poverty of these countries as well as to domestic political and institutional factors. In spite of the obvious difficulties of presenting a general picture of the situation of 50 very heterogeneous countries, we attempt in Chapter 5 to summarise some of these domestic development constraints.

A large proportion of the study deals with global trade policies, and the new "rules of the game" that are currently under establishment.

Chapter 6 is an introductory discussion of tariffs and other important trade barriers which confront the LDCs on their major export markets.

The development of the new global trade organisation is described: from GATT (General Agreement on Tariffs and Trade) via the Uruguay Round to the present day WTO in which the framework of current LDC market access is decided (Chapter 7). The Special and Differential Treatment provisions in the form of exemptions and special regulations which apply to the developing world in general, and to LDCs in particular, are examined. We also look at the special dispute settlement mechanism which has been established within the WTO framework; for the first time global regulations within the trade area have been equipped with mandatory regulations for conflict management and sanctions.

The central, original GATT principles – equal treatment for all countries and the Most Favoured Nation principle – live on in WTO. In our discussion on the GATT Agreement in Chapter 8 we present these basic principles. A number of other agreements that were part of the Uruguay Round and which affect trade in goods are also described. These agreements also affect countries' opportunities to subsidise production, impose temporary tariff barriers and anti-dumping tariffs, set health requirements and make specified demands on foreign investors.

The two sectors in which LDCs, at least in the short term, would probably have most chances of developing competitive exports are agriculture and textiles/clothes. The latter is an important source of employment opportunities and, at least potentially, export revenues for many LDCs. In Chapter 9, these opportunities are discussed as are the possible effects – and risks – for LDCs of the dismantling, in January 2005, of the infamous Multi-fibre Agreement which in the past regulated most of the global trade in textiles and clothing.

Chapter 10 deals with the agricultural sector, both its central role in supporting the majority of the population in LDCs and the policy regulations governing its trade. Special emphasis is placed on the WTO Agreement on Agriculture and the destructive effects of industrialised countries' protectionist agricultural policies and dumping of greatly subsidised agricultural exports.

In contrast to the previous GATT agreement whose mandate was limited to industrial goods, WTO is empowered to include agriculture (see Chapter 10 mentioned above), plus trade in services and intellectual property i.e. issues covering patents and copyright. The implications of the new GATS (General Agreement on Trade in Services), and TRIPS (Trade-related Intellectual Property Rights) for LDCs are discussed separately in Chapters 11 and 12. One conclusion is that both these agreements, as with other specialised agreements, are not adapted to the interests and development needs of the least developed countries.

After these chapters primarily dealing with WTO agreements, Chapter 13 presents various bilateral trade and preference agreements concluded by LDCs. The most important of these is the Cotonou Agreement with EU which covers most LDCs and provides trade concessions on EU's inner market. The implications of the Economic Partnership Agreements (EPAs), which the EU wishes to succeed the current Cotonou Agreement, are also discussed. Our main conclusion in this context is that the EPAs offer few benefits, but various potential risks, for the least developed countries.

The major part of the study deals with issues concerning international trade policies and LDCs' access to the markets of the richer countries. However we also touch on increasingly important issues concerning the current powerful trend towards regionalisation, i.e. the establishment of regional free trade areas, customs unions and other forms of cooperation, not least as concerns south-south cooperation in the trade policy area (Chapter 14).

Chapter 15 presents an overview of the rise and fall of the Doha Round of WTO negotiations, lasting between late 2001 and mid-2006. The emphasis is on an analysis of the increasingly assertive role played by the developing countries in the three Ministerial Conferences during the Doha Round (Doha in 2001, when the Round was launched, Cancún in 2003 and Hong Kong in 2005) and on the most contentious issues which led to the present deadlock, in particular the industrialised countries' refusal to undertake the agricultural policy reforms demanded by developing countries. We also present an overview of the controversial "Singapore issues" (competition, investment, trade facilitation and public procurement) which the OECD countries, and in particular the EU, wished to be included on the WTO agenda, but which developing countries have opposed.

In the final chapter we present a summary of some of the most important conclusions of the study, and recapitulate our central recommendations as concerns reform of international trade regulations.

It should be emphasised that this study is not aimed at specialists in foreign trade. The ambition has been to integrate trade issues into an overall development perspective, and to discuss the current and potential role that trade can play in the economic and social development of LDCs. It is also from a development perspective that we evaluate the rules and regulations governing the world trade system and examine both the internal and external constraints experienced by LDCs in their efforts to benefit from globalisation and from a closer and more advantageous integration into the world economy.

Presentation of LDCs

CHAPTER 1

1.1 Key data

Of the 50 countries that are currently classified as least developed countries the majority, or 34 in total, are found in sub-Saharan Africa. Ten LDCs are in Asia, while the other six are in the Caribbean and Pacific Ocean areas (see Appendix 1 for a brief presentation of all the LDCs).

In terms of population, the largest LDC is Bangladesh, whose over 140 million inhabitants account for around one fifth of the entire LDC population and for approximately one quarter of the GDP of the group.

Many of the LDCs are tiny. Over twenty have fewer than five million inhabitants and several, mainly smaller islands in the Pacific Ocean, fewer than one million. Altogether over 740 million people, almost twelve percent of the earth's population, live in LDCs. In contrast, however, their share of the world's entire GDP amounts to no more than 0.6 percent.

Exactly what proportion of the world's poor live in LDCs is difficult to estimate, but it possibly adds up to around one third. The fact that the LDC group includes the world's very poorest countries does not necessarily mean that the majority of poor people live in these countries.

All social and economic indicators reveal deep, widespread poverty in LDCs. The group's average per capita income is only around USD 340, compared with over USD 1,600 per capita in developing nations as a whole (UNCTAD, *LDC Report 2006*, p. 311). Table 1.1 below shows per capita income expressed in Purchasing Power Parity, (PPP).

Forty five per cent of the LDC population are estimated to be living in absolute poverty and 75 per cent have an average income of less than two dollars a day. Life expectancy is only 52 years, against 65 years in developing nations in general, and infant mortality exceeds 100 per 1,000 live births (UNDP, *Human Development Report 2006*, p. 286).

Not the least worrying from a long-term development perspective is their low and stagnating investment in human development. The share of GDP allocated to education, around three per cent, has been stagnant or has declined during the past twenty years. Healthcare expenditure is a modest USD 15 per head per year, compared with over USD 100 in other developing nations and about USD 2,700 in OECD countries. In addition, many LDCs are amongst the worst hit by the HIV/AIDS epidemic.

Table 1.1: LDCs: Basic Data on Economic and Human Development

	1990	2004
GDP per capita, PPP (constant 2000 USD)	1 063	1 242
Life expectancy at birth (years)	50	52
Literacy rate (% of people aged 15 and above)	44	54
Under 5 mortality rate (per 1,000)	182	155
Population, millions	521	735
Human Development Index (HDI)		0.52

Source: World Bank, *World Development Indicators*, www.worldbank.org, UNDP, *Human Development Report, various issues, www.undp.org*

1.2 Trends in the last few decades

The 1980s, marked by the debt crisis and falling commodity prices, were a "lost decade" for many countries in Africa and Latin America. Most LDCs were amongst the losers, and average per capita income was substantially lower at the end of the decade than at the beginning.

The 1990s brought a certain degree of stability for the LDC group as a whole, but the differences in rates of development between countries were accentuated. The modest 0.9 per cent average growth in per capita income for LDCs between 1990–99 as compared with a full 3.6 per cent in the developing world as a whole, largely due to rapid growth in China, India and much of Asia, conceals extreme differences. If Bangladesh, which enjoyed strong growth throughout the decade, were excluded, per capita growth in the LDCs would drop from 0.9 to 0.4 per cent. Almost half of all LDCs, mostly those in sub-Saharan Africa, recorded zero or negative growth.

In the early years of the 21st century the majority of LDCs have experienced a recovery in economic growth and a combination of favourable export prices and improved macroeconomic management has resulted in rather promising growth 2003–2006. It remains to be seen whether this encouraging development signals a new trend or merely a temporary improvement.

Whichever economic indicator we choose, the picture of continuing marginalisation of LDCs in the world economy is confirmed, especially of those in Africa. The LDCs' share of world trade – which exceeded one percent in the 1970s – has fallen considerably to approximately 0.4 per cent of world exports and 0.6 per cent of world imports in 2004 (WTO, *World Trade Report 2006*). Their share of trade in services is even smaller at 0.1 per cent.

Two LDCs – Bangladesh (garments) and Angola (oil) account for over one fourth of all LDC exports.

The last few years' slight recovery of LDC exports is largely due to the high prices of a few commodities such as oil and minerals.

The flow of public and private capital to LDCs has stagnated (although it is anticipated that Chinese investment in Africa will increase in the future). Foreign direct investment (FDI) continues to be very low, as are other flows of private capital. China and other successful economies in Asia, plus a few of the middle-income countries in Latin America, have attracted most available foreign investment during the past decade. The LDC group's share of the total flow of private capital to developing nations fell from 18 to 4 per cent during the 1990s and the group has received just 1.5 per cent of all direct foreign investment in developing nations in recent years.

Of the small amount of FDI going to LDCs, the lion's share – over 70 per cent – went to oil and mineral-exporting countries (UNCTAD, *LDC Report 2006*, p. 21).

Table 1.2 illustrates the distribution of FDI between different developing regions in 2004.

Table 1.2: Foreign direct investment, developing countries, 2004

	FDI inflows		**FDI outflows**	
Region	USD million	% of world	USD million	% of world
America	67 526	10	10 943	1
Africa	18 090	3	2 824	0
Asia	147 545	23	69 422	10
Oceania	67	0	1	0
LDCs	10 702	1.5	110	0

Source: UNCTAD *Handbook of Statistics*, www.unctad.org, June 2006.

Development aid (ODA) to LDCs was cut back sharply in the 1990s and in the first few years of the current decade but has recovered since 2002. In real terms, assistance to the this group fell by 45 per cent between 1990 and 1999 and, despite a slight increase in recent years, ODA to the LDCs is still not much above the levels reached fifteen years ago. On a per capita basis, the volume of ODA has declined. (For further data, see Chapter 4.)

Table 1.3: ODA to LDCs 1980, 1990, 2000 and 2004

Years	Current USD (millions)	Constant 2003 USD (millions)
1980	8 742	16 327
1990	16 751	19 954
2000	12 682	14 899
2004	24 908	22 732

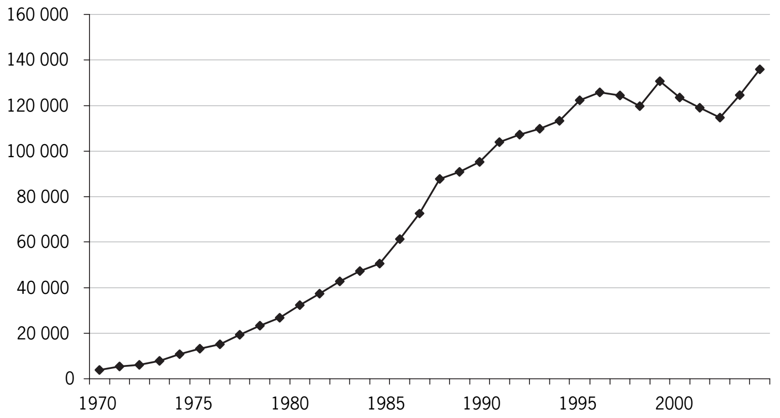
Source: OECD Development Statistics, www.oecd.org

Total ODA to LDCs – excluding aid from China, which is increasing rapidly mainly in the form of concessional credits – amounts to just over USD 20 billion per year, compared with total export earnings of over USD 50 billion. Or put another way: foreign aid finances around 40 per cent of total imports to LDCs, against just a couple of per cent in developing countries as a whole.

Until quite recently, the foreign debt situation was worsening in the majority of LDCs. In the LDC group, foreign debt – in both absolute terms and as a proportion of GDP and exports – was substantially higher in 2003 than in the 1980s or 90s. A number of low income countries eligible for debt relief under the HIPC initiative (Highly Indebted Low Income Countries) have, however, seen their debt burden reduced in the last few years.

The stagnating volume of ODA is in stark contrast to commitments made by the OECD countries at the second LDC conference held in Paris in September 1990. According to the final resolution – "Programme of Action for the Least Developed Countries in the 1990s" – that was adopted after this conference, every effort would be made to reverse the tendency towards a worsening of the socio-economic conditions that prevailed in LDCs during the 1980s, and assistance would be substantially increased. For instance, ODA from the industrialised nations was to be increased from 0.09 per cent to at least 0.15 per cent of the national income of richer countries, and preferably by much more. In actual fact, this figure fell to 0.05 per cent of the GNI of the OECD countries. And in most other respects it should be stressed that very few of the promises made at the Paris

Figure 1.1 External long-term debts of LDCs, millions of current USD, 1970–2003



Source: Based on *OECD Development Statistics*, www.oecd.org

conference – repeated at subsequent LDCs conferences as well as at the March 2002 International Conference on Financing for Development in Monterrey, Mexico – have been realised.

Another factor of great importance in the 1980s and 90s was the adverse price development of most LDC export goods. The LDCs are net exporters of raw materials, and commodity prices continued to fall dramatically during the 1990s. Not least a number of agricultural products suffered declining world market prices as a result of, among other things, the massive dumping of food surpluses by the European Union and the USA (see further Chapter 10). To which can be added the fact that raw material producer prices appear to have fallen significantly faster than consumer prices in markets in the major industrial countries. According to one study[1], the difference between producer and consumer prices doubled between the mid 1970s and mid 1990s, and the share of the final retail price of agricultural products accruing to the producer countries has declined substantially, showing that value added has moved North, i.e. in favour of the processing, distribution and marketing activities largely found in the developed countries.[2]

1 See Jacques Morisset in *The World Bank Economic Review* Vol. 12, No. 3, 1998. On the basis of comprehensive empirical material, Morisset draws the conclusion that "…the declines in world commodity prices were not transmitted or were transmitted imperfectly to domestic consumer prices. In contrast, upward movements in world prices were clearly passed on to domestic prices. As a result, the spread between world and domestic prices almost doubled in all major commodity markets." (p. 503).

2 See Ashafa (2005).

Terms of trade for the LDC group are far below the levels reached in the 1970s. The last few years have, however, witnessed a recovery of commodity prices, largely as a result of a dramatic surge in demand from China and other Asian countries short of raw materials. LDC exports to Asia are growing much faster than to any other region in the world, and prospects for a rapid increase in trade with Asia appear good.

On the negative side is the fact that oil prices, in particular, have increased; a majority of LDCs are net importers of oil.

Although the LDCs can be said to have been hit by adverse international economic developments in terms of declining ODA (in the 1990s), price-depressing dumping from OECD countries and worsening terms of trade, it would nonetheless be misleading to place most of the blame for their unfavourable economic development on external factors. The poor economic development in African LDCs in particular – and also in other LDCs such as Afghanistan, Haiti and Myanmar – is due more to domestic factors, including in many cases political instability and poor economic policies.

The HIV/AIDS disaster has also contributed to exacerbating their economic and social pain. In many of the African LDCs, HIV/AIDS has already led to a dramatic reduction in average life expectancy while the human, social and economic costs during the next few decades will be unimaginable.

There is a strong link between political unrest and economic stagnation. Many of the LDCs are dictatorships or quasi- dictatorships with weak popular support. It is significant that all eleven LDCs that recorded a fall in per capita income of over three percent annually in the 1990s were also countries wracked by armed civil conflict and political instability.

It is also worth emphasising that the structural adjustment programmes supported by the IMF and World Bank[3] and implemented by the majority of the LDCs – over longer or shorter periods of time, and more or less wholeheartedly – failed to bring the desired positive effects of growth and development. In many countries, these programmes led to even greater poverty and inequality.

1.3 The concept of LDC and the advantages and disadvantages of LDC status

The concept of LDCs arose from a UN initiative in 1971, and initially included 24 different nations with very low per capita income. The list of LDCs has

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3 These programmes basically aimed at low inflation and macroeconomic stability, deregulation and privatisation and were a cornerstone of the conditionality imposed by World Bank, the IMF and many bilateral donors during most of the 1980s and 90s.

since grown steadily and now embraces 50 countries. The latest countries to be accorded LDC status were Senegal (in 2000) and Timor Leste (2003). Only one country, Botswana, has "graduated" from the group.

A working group from the UN Economic and Social Council is responsible for the actual classification which has often been a delicate task. On the initiative of a number of low-income countries that have sought LDC status, certain other criteria have been added to the original income criterion. At the time of the 2003 review of the list of LDCs by the UN, the following three criteria were used (Source; UNCTAD):

– *low income*, based on a three-year average estimate of gross national income (GNI) per capita. Under USD 750 for cases of addition to the list, above 900 USD for cases of graduation:
– *weak human assets*, in the light of a composite Human Assets Index based on indicators of nutrition, health, school enrolment and adult literacy;
– *economic vulnerability* according to an Economic Vulnerability Index based on indicators of instability of agricultural production, instability of exports, economic diversification, export concentration and small economic size.

A further criterion, or more properly a restriction, is that the country must have a population of less than 75 million (this criterion was not in force when Bangladesh, the only LDC country with a population of more than 75 million, gained LDC status in 1975).

Any country to be added to the list of LDCs must meet the above three criteria. Even if all the criteria are not met, countries may gain LDC status if special circumstances dictate. Similar principles apply for graduation from the LDC group – if certain cut-off points or limits are exceeded, the country should leave the LDC group.

In actual practice, however, the question of whether or not a country is classified as an LDC is a matter of negotiation. As a rule, LDCs oppose graduation; examples are the Samoa Islands and Vanuatu which the UN recommended should leave the LDC group, but which managed to retain their LDC status after intense pressure.

The reason that many countries find it attractive to retain/seek membership of the LDC group is the potential economic advantages associated with LDC status. The benefits include increased levels or improved terms of assistance which are reserved for LDCs only. In connection with debt rescheduling, LDCs can sometimes expect more favourable treatment. Those LDCs that are members of the WTO enjoy, which will be discussed in more detail later in subsequent chapters, a series of advantageous exemption clauses that are not open to other developing nations. There are also various proposals in the trade policy area that are directly aimed at affording LDCs special export privileges – for example the widely discussed EU initiative (EBA, "Everything but arms" – see Chapter 6.2) to allow virtually all goods from LDCs to be imported duty-free. At the latest WTO Ministerial Meeting in Hong Kong in December 2005, the United States indicated – although in rather vague terms, and with a large number of exceptions for "sensitive products" – a willingness to implement a similar preferential scheme for LDC exports. Several middle-income countries have also made commitments in this direction. Nothing significant is likely to happen to fulfil these promises, however, until the present deadlock in the WTO is broken.

For the industrialised nations, the LDC concept can be politically convenient in that the LDCs may be granted favourable treatment that does not cost much but which demonstrates that the rich countries are prepared to provide special support to the very poorest nations in the world.

There can also be disadvantages associated with belonging to the LDC group. One of these is the "image" the country acquires through membership which can result in less interest from foreign investors and trading partners. These drawbacks are, however, rather more vague and uncertain than the benefits that membership in the LDC group may bring.

It ought to be clear from this brief summary that the issue of LDC criteria is far from unproblematic. There are powerful incentives for belonging to the LDC group, and clear risks of conflicts both within the LDC group – which is extremely heterogeneous – and between the LDCs and other developing nations. Naturally other developing nations are not always thrilled by the fact that the LDCs are awarded special privileges when it comes to issues such as ODA or debt relief.

Conflicts can also arise in the area of trade policy over, for example, the right to exemption from import duties and the issue of rules of origin, when two neighbouring countries produce more or less the same products and are more or less equally poor, but one of the countries has LDC status and the other does not.

It should also be noted that the majority, if far from all LDCs, also have ACP status[4] in relation to the EU according to the Lomé Convention and its successor, the Cotonou Agreement. In the areas of ODA and trade policy, ACP membership will probably be a substantially more important factor than membership of the LDC group (see Chapter 13).

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4 The group of developing countries in Africa, West Indies and Pacific Ocean that are the signatories with the EU to the Cotonou Agreement and, before 2000, the Lomé Conventions. (See Chapter 13).

1.4 LDCs and WTO – an introduction

Later chapters deal in more detail with the World Trade Organisation and its influence on LDCs. However, it is worth emphasising several important aspects at this point.

To begin with, it can be established that in the past the LDCs have generally shown little interest in issues concerning trade policy and WTO. Even today, 18 of the 50 LDCs are not members of WTO.

In GATT (General Agreement on Tariffs and Trade), i.e. WTO's predecessor, and during the Uruguay Round which led to the formation of WTO in 1995, LDCs maintained a very low profile and as a rule, the interests of developing nations were propagated by middle income countries such as Brazil and Mexico and by countries such as India which maintain powerful representation at all international organisations. However the LDCs have shown appreciably more interest in trade policy issues in recent years, as have developing countries generally, and several of them are increasing their level of participation in WTO.

The growing interest among LDCs in taking active part in WTO negotiations is also, and perhaps primarily, explained by the fact that WTO today deals with a wide range of issues which affect key areas of domestic policy-making but which are only indirectly related to the old GATT mandate of dealing with "tariffs and trade". One strategy from the OECD countries since the foundation of WTO has been to try to add an increasing number of entirely new issues to the WTO agenda, something which the developing countries have usually been reluctant to accept.

Among the LDCs, Bangladesh is traditionally one of the most active of the developing nations in WTO. Bangladesh is, however, not very representative of an LDC with its much more dynamic and diversified range of exports than other countries in the group, and with its much greater capacity for trade. On many issues the national interests of Bangladesh are more in line with other developing nations than with other LDCs.

One important reason for the relative passivity of the LDC group in the area of trade is that fundamental development problems in the majority of these countries are less to do with market access and more to do with supply constraints i.e. difficulties in actually producing something that is possible to sell. The primary reason for low exports from LDCs is their lack of production capacity. In this respect, there is a substantial gap between the LDCs and most of the middle-income countries, whose behaviour within the WTO to a larger extent focuses on improved access to the markets of the rich nations.

As a consequence of the overall reduction of tariffs that has characterised the global trading system over the past decades it should also be stressed that the most serious obstacles to market access are more to do with non-tariff barriers to trade. This is particularly true for the LDCs.

It is also worth mentioning that those LDCs that have joined the WTO have been granted a number of exemptions from various trade policy demands, and extensions for implementing certain trade policy reforms. For the LDCs as a whole, the rules and regulations are therefore – at least for the moment – less binding than for other countries. Put somewhat simply, it can be said that the rich nations are not that bothered about what the LDCs, with just about 0.5 percent of world trade, do or do not do. To date, no LDC has been directly involved, whether as plaintiff or defendant, in any case that has been dealt with within the WTO mechanism for resolving disputes.

However, the opposition to the proposal to allow duty-free trade for LDC exports to the EU for more or less all goods – the EBA initiative – that was generated within certain EU producer circles shows that the mere threat that the poorest nations on earth might increase their modest level of exports to the protected EU market is sufficient to mobilise strong protectionist reactions against such measures. The intense "cotton dispute" between four poor cotton-producing West African countries and the United States, which continues to dump its heavily subsidised cotton on the world market, is another example of trade-related conflicts which directly affect a number of LDCs.

For the majority of LDCs there are more important issues than global trade policy rules and regulations (and even within trade policy, the EU's and USA's bilateral rules and regulations are often of greater importance than WTO's). Bilateral trade agreements, ODA issues and debt relief therefore tend to come higher up the LDC agenda than the WTO. The EU and Brussels, and the IMF/World Bank and Washington, are more important than the WTO and Geneva. For many of the most indebted LDC nations, Paris, where the Paris Club convenes to consider issues surrounding debt relief, may be more important than Geneva.

As a whole, LDCs are still very poorly represented at the WTO. Some 20 LDCs do not have any permanent representation in Geneva to monitor WTO issues. Back in their capital cities, LDC governments often express little or no interest, and detailed knowledge of trade policy issues is limited.

The rich nations enjoy, de facto, an enormous advantage. Each OECD country has on average seven WTO officials stationed in Geneva. Back home, they have excellent access to numerous experts on various trade policy issues. Before the suspension of the Doha Round in July 2006, when general negotiations came to a standstill, almost 50 trade policy meetings were held in Geneva every week, which in itself indicates that the LDCs had very little scope to monitor and influence proceedings.

It is also far from obvious that the LDCs always share common trade policy interests. One example is trade in agricultural products (see Chapter 10). One major developing nation demand has long been that the rich nations should open up their markets to poor countries, and stop dumping subsidised agricultural products on the world market. For many LDCs, this issue is more complicated. Most LDCs export agricultural products, generally cash crops such as coffee, sugar, bananas and peanuts, but at the same time are net importers of staples such as cereals. In the short term at least, certain LDCs gain from the agricultural policies of rich countries and their export of cheap foodstuffs and are concerned about the risk of rising world market food prices if the current system of subsidies were to be abolished in the richer countries.

Trade and development

CHAPTER 2

2.1 Foreign trade theory: a brief review

2.1.1 Ricardo and comparative advantages

Few economic theories have stood the test of time better than David Ricardo's almost two hundred year old theory of comparative advantage, or comparative costs. In contrast to the previous mercantilist views – that exports are good, imports bad – Ricardo did not consider foreign trade to be a zero sum game but rather as something mutually advantageous. If two or more countries specialise in producing the goods for which they have comparative advantages, all parties gain by the exchange of trade.

Free trade, and specialisation according to each country's comparative advantage, benefits all countries.

One important refinement of Ricardo's basic model was the famous Heckscher/Ohlin theory, which can still be found in economics textbooks. According to Heckscher/Ohlin, the comparative advantages of different countries and the related patterns of trade that go with them can be explained by examining the differences in access to production factors in different countries. Or, put in simple terms: countries rich in natural resources export raw materials. Countries with plenty of labour but little capital tend to export labour-intensive goods and import capital-intensive products.

Ricardo and Heckscher/Ohlin were perfectly right in one crucial respect: every country is able to find comparative advantages somewhere. There is one complication however, the theory of comparative advantage does not guarantee that each country can be internationally competitive in any major sector of the economy at *wages above subsistence level*.

This is an important caveat for countries where productivity is very low – as it is, almost by definition, in LDCs.

Suppose a low-productive country tries to export textile products, or coffee, on a world market where it competes with Vietnam for example. Let us further suppose that labour productivity is five times higher in Vietnam as a consequence of the Vietnamese workforce's better education and Vietnam's superior access to finance, modern technology and infrastructure. If the average wage in Vietnam is USD 100 per month, the low-productive country would then need to pay its workers twenty dollars per month or less in order to compete with Vietnamese exports.

But no-one can possibly support a family on twenty dollars a month. The wage that would enable the country to compete with Vietnam would have to fall appreciably below subsistence level.

Or, formulated in another way: the still low wages in some of the successful East and South Asian countries, in combination with a rapid rise in productivity, are today exposing many developing regions – sub-Saharan Africa, in particular, but also parts of Latin America and the former Soviet Union – to fierce competition which makes it difficult for low-productive countries to compete without offering their workers below-subsistence wages.

In many LDCs, the difficult situation confronting exports is compounded by the fact that their farmers are forced to compete with subsidised food surpluses which the industrialised countries continue to dump on the world market as well as on developing countries´ domestic markets.

2.1.2 Static and dynamic effects

One problem with all models based on Ricardo is their static nature. The comparative advantages of countries are taken as given. Full utilisation of all factors of production is presupposed. The welfare benefits of foreign trade are a one-off event, and are illustrated by a comparison between two states of equilibrium, respectively with and without trade. Allocative efficiency is undoubtedly higher with trade and specialisation according to comparative advantages. However, nothing can be said about effects on long-term growth.

For poor countries, for which growth and development are central issues, Ricardo's static model appears inadequate. With obvious exceptions (e.g. oil deposits) most comparative advantages are not bestowed by nature – there is, for instance, no genetic explanation as to why the Swiss are good at making watches or managing banks – but are *acquired*, and a country's comparative advantages are constantly being upgraded and changing during the development process itself. The speed at which this can be carried out is illustrated by the most successful industrialised countries of East Asia. In the space of a generation or so, countries like Taiwan and South Korea have dramatically changed their comparative advantages and export structure from cheap labour, simple textiles and toys to advanced, knowledge-intensive products and services.

Dynamic effects play a much more important role in modern foreign trade theories than in the static models of Ricardo or Heckscher/Ohlin. The numerous positive dynamic effects usually mentioned include the following:

- Trade enables the utilisation of *economies of scale*. This is of central importance to the very poorest developing nations whose domestic markets are totally inadequate for industrialisation based solely on local demand. The entire domestic market for industrial goods in an average LDC is smaller than that of a medium-sized Swedish town. However, export-led growth can open the door to economies of scale within a few niche areas. A recent example of successful export-led industrialisation in a very small country is Mauritius.
- *Increased competition* through trade. Companies are forced to become competitive on export markets, and external competition is often required on protected home markets in order to raise productivity and exert pressure on monopoly prices.
- Foreign trade as the bearer of *new technology*. Direct foreign investment in the export sector can also play an important role in this context.

Taking new technology in the broader sense, other aspects can also be included such as modern principles of business management, marketing, accounting, quality control, new international customer contacts etc.

In general, the awareness of the importance of "software" – institutions, networks, contacts, human resources, etc. – is growing in today's globalised economy (see Chapter 3). Consequently the role of foreign trade as the agent of new impulses and ideas is becoming increasingly decisive at the expense of access to "hardware" (raw materials, machinery, etc).

- Raising *corporate finance* can be facilitated. As a rule, private companies in poor countries have limited access to capital, and foreign trade can open the door to finance opportunities that would otherwise be closed to companies operating on the domestic market only.

Openness to trade may also have beneficial *policy effects*, for example by creating incentives for governments to pursue less distortionary domestic policies and more disciplined macroeconomic policies.

Modern trade theories also place greater emphasis on the strategic importance of imports. The size and composition of imports can play a decisive role in growth and development opportunities for poor countries. Unfortunately, trade policy discussions often show a strong mercantilist bias, underpinned by powerful vested interests afraid of competition: exports are good and provide jobs and export revenues, consequently imports must be bad and eliminate jobs and worsen the balance of payments situation. This mercantilist approach is also demonstrated in the political games played out at WTO. If a country grants foreign exporters the opportunity to compete on equal terms (which is excellent for consumers in the country!) this is a "concession" that should be balanced out by other countries granting equivalent "concessions" concerning market access.

The point of departure in this study is that it is the dynamic advantages of foreign trade that are ultimately decisive for LDCs, as these countries must focus on economic growth and sustainable human and social development.

2.1.3 Is free trade always good for everyone? Some critical views

During the 1950s and 60s a wave of criticism against the free trade doctrine swelled and broke. We do not claim to summarise the lively debate that occurred during that period, but a few glimpses at the prevailing ideas of the time may be in order to provide some historical colour to current discussions.

A great deal of criticism was directed at what was perceived to be an idealised view of the blessings foreign trade brought to developing nations. Raúl Prébisch (the first and extremely influential Secretary General of UNCTAD), Ragnar Nurkse and various other famous economists claimed that the long-term export prospects for raw material producers were extremely bleak. As a consequence of factors such as industrialised country protectionism, low income elasticity of the developing nations' most important export goods, falling raw material contents in modern industrial goods and a successive transition from natural to synthetic materials, prices of raw materials as compared to finished goods would be inexorably weakened.

Other arguments that pointed in the same direction, i.e. warnings about continued dependence on the export of raw materials in an uncertain world market, were that commodity prices tend to fluctuate more than earnings from exports of industrial goods (Gunnar Myrdal and others). Some authors (Nurkse, Myrdal and others) also stressed that the dynamic effects of raw material production are insignificant in terms of enhancing educational and technological development, and that technical advances in such production tend to be transferred to consumers in rich countries in the form of lower consumer prices (Prébisch, Hans Singer and others) rather than in the form of higher margins for producers. Another common argument was that the industrialised nations control raw material prices through the powerful bargaining position of their transnational companies.

Criticism has also been levelled at the static nature of concepts such as comparative advantage. Should poor countries really be satisfied with having comparative advantages in commodities such as peanuts and bananas, while rich countries are constantly improving their comparative advantages in modern industry and advanced services?

Criticism of the traditional foreign trade theory and the doctrine of free trade was linked, naturally enough, with recommendations for rapid industrialisation. The catchword was "import substitution". With the help of tariffs and other barriers to imports, domestic industries in developing nations were to be protected against competition from developed industrialised nations.

This message elicited considerable response from influential groups in developing countries. Import substitution strategies also became attractive to emerging political leaders in the third world: many problems could be blamed on external factors (colonialism and imperialism according to radical leaders, unfavourable trading conditions and deteriorating terms of trade amongst the less radical), while industrialisation policies and protectionism were politically rewarding tools to expand the role of the state in the domestic economies and boost the national identities of political leaders (and sometimes their power and sources of income as well).

During the 1950s and 60s, more or less sophisticated import substitution strategies were applied in the overwhelming majority of all independent developing nations. In certain cases protectionism was a purely defensive move in an attempt to protect a precarious balance of payments situation; this was the case when import substitution policies were first introduced in Latin America during the great depression of the 1930s. However in other cases, industrialisation based on import substitution became the cornerstone of official development policies. The majority of ODA providers from the industrialised nations and international development banks also favoured these industrialisation policies and helped finance them.

During the last few decades we have witnessed what could be called the renaissance of Ricardo, at the expense of industrialisation based on import substitution and protected domestic markets. Criticism of the import substitution strategy has included such factors as the insignificant size of domestic markets in most developing nations and inefficiency and rent-seeking behaviour or outright corruption in protected industries. The discrimination against the agricultural sector which often resulted from industry's preferential treatment also came under attack when food production stagnated as the domestic terms of trade for agricultural products deteriorated.

"Export promotion" gradually replaced "import substitution" as the conventional wisdom. The debt crisis of the 1980s further strengthened this tendency.

With structural adjustment programmes and conditionality as powerful levers, a large majority of the world's poor countries have now adapted their economies along more liberal, free trade-friendly lines. At the same time, international organisations such as the World Bank, GATT and later WTO have purposefully worked to successively reduce tariffs and other types of trade barriers to world trade – although without success in important areas such as the agricultural policies of richer countries (see Chapter 10).

The 1980s and 90s witnessed mere pale echoes of the criticism of the free trade doctrine first heard several decades (or even centuries) ago. Only a handful of economists adhere to protectionism today, and very few leading politicians advocate inward-looking development strategies. Concepts such as "self reliance", which were frequent a few decades ago, are now brushed aside as destructive or simply ridiculous.

However, despite the free trade-friendly spirit prevalent today, not all criticism should be dismissed as ridiculous or based on ignorance. Not all claims made by the supporters of import substitution policies were wrong, and new questions have arisen. There is an apparent swing of the pendulum in recent development theory debates. We will conclude this short discussion on trade theory with a brief account of the most important dividing lines today: what does everyone seem to agree on, and what is under contention?

2.1.4 Where do we stand today? What issues remain?

> *"Openness to international trade accelerates development of poor countries: this is one of the most widely held beliefs in the economics profession, one of the few things on which Nobel Prize winners of both the left and the right agree."*
> (David Dollar & Aart Kraay, 2000, p. 3)

It is easy to summarise what virtually every leading economist and politician is in agreement on today: international trade is both good and necessary. In today's globalised world economy every attempt at protectionism and "self reliance" is a *cul-de-sac*. Not least for the very poorest countries, increased trade is an absolute necessity for social and economic development.

But let us also highlight a few question marks and outstanding areas of disagreement. The above quote from David Dollar and Aart Kraay – fervent and well-known advocates of globalisation and free trade – should perhaps be modified slightly, so let us define some subtle differences.

Firstly, there is still a great deal of concern about the position of raw materials producers in the world economy, concerns which were first raised by many critics of the free trade doctrine several decades ago. After dramatic hikes in the 1970s, commodity prices fell to very low levels in the 80s and 90s. In many areas this tendency has been reinforced by the somewhat desperate attempts by many poor countries to export their way out of the debt crisis by increasing their exports of raw materials. Individually, these countries have been too insignificant to influence world market prices, but when a number of countries have sought to export the very same products at the same time – commodities such as coffee, sugar, rice, cotton, natural rubber and cut flowers – this has resulted in further price falls.

It is too early to tell if the last few years' surge in commodity prices – partly as a consequence of the "China factor", i.e. the greatly increased demand for oil and all kinds of raw materials from China and other rapidly growing Asian countries – is the beginning of a new trend or whether it represents a temporary boom such as the one witnessed in the 1970s.

New worries surrounding the environment and sustainable development can now be added to earlier concerns about declining terms of trade, dramatic price fluctuations and greater vulnerability. Many of the niche areas that poor countries have gained a foothold in – such as cut flowers, timber or prawns – have now been shown to be associated with serious environmental problems.

For these and other reasons, there is now growing scepticism to one-sided raw materials extraction according to static theories of comparative advantage.

The unprecedented successes achieved by several Asian countries have also contributed to an intensive debate on the possibilities of pursuing a non-orthodox development policy. Countries such as Taiwan, South Korea and Malaysia have not slavishly followed the economics textbooks when it comes to free trade; on the contrary, these "success stories" have largely relied on a recipe heavily dependent on government industrial policies, old fashioned import substitution (during the initial phases of industrialisation) and selective export subsidies. Many of the instruments that have been used – tariffs and quantitative controls, demands for "local content" in foreign direct investments, targeted credits, export subsidies, etc – have also been of a kind that are contrary to many of the rules and regulations within the WTO regulatory framework.

It should also be stressed that today's industrialised countries, without exception, applied a large number of "unorthodox" economic policy measures during their initial stages of development (and many still do, although to a much lesser extent than earlier). State subsidies and various forms of state intervention, including tariff protection, were common, and many developing countries are concerned that their opportunities to pursue development strategies which were once successful in the world's rich countries are gradually being outlawed by the global regulatory framework that is currently emerging.

The numerous failures that surrounded structural adjustment programmes in the 1980s and 90s have also provided ammunition for criticism of what came to be known as the "Washington Consensus", i.e. the now strongly discredited accord between the IMF and the World Bank (and the majority of bilateral ODA donors) around the liberalisation and privatisation policies integral to these programmes. One of the most influential of these critics is the former Chief Economist of the World Bank, Joseph Stiglitz who, in a series of articles and speeches, has criticised these policies. Stiglitz is especially critical in the area of trade policy where he claims that dogmatism rather than pragmatism has coloured many of the demands for rapid liberalisation of international trade and currency markets in poor countries.

Stiglitz, and many like him, prescribe a pragmatic and gradualist strategy instead. Although very favourable towards international trade, Stiglitz warns against the effects of dramatic liberalisation and indicates some of the risks. A couple of quotes (taken from Stiglitz, 1999) that are of particular relevance to LDCs illustrate these:

On the risks of unemployment:

> *"Standard economic analysis argues that trade liberalization – even unilateral opening of markets – benefits a country. In this view, job loss in one sector will be offset by job creation in another, and the new jobs will be higher-productivity than the old… This economic logic requires markets to be working well, however, and in many countries, underdevelopment is an inherent reflection of poorly functioning markets. Thus new jobs are not created, or not created automatically. Moving workers from a low-productivity sector to unemployment does not – let me repeat, does not – increase output." (p. 4).*

On income distribution:

> *"Although the country as a whole may be better off under free trade, some special interest groups will actually be worse off. And although policy could in principle rectify this situation… the required compensations are seldom paid…*
>
> *There are real losers who are seldom compensated and among these losers are some who are relatively poor… Given the lack of compensation, trade liberalization may actually lower social welfare, if due weight is given to the welfare of the poor." (p. 8).*

On the risks of increased vulnerability and volatility:

> *"Complete openness can expose a country to greater risk from external shocks. Poor countries may find it particularly hard to buffer these shocks and to bear the costs they incur, and they typically have weak safety nets, or none at all, to protect the poor. In recent work… I have shown that small and more open developing countries suffer more volatility in their growth performance than do other countries." (p. 11).*

On the subject of vulnerability it can also be noted that the question of food security in the event of total deregulation of domestic agriculture plays an important role in many developing nations. There is widespread concern that WTO rules restrict opportunities to protect and support LDCs' agricultural sectors and can impinge upon food security in poorer countries (see Chapter 10).

Dani Rodrik[5] is another influential economist who wishes to introduce more nuances into the debate. In common with the majority of other economists who have expressed scepticism about the most extreme of free trade proponents, Rodrik is basically in favour of integrating poor countries into the world economy, but argues that domestic policies play the most important role. Trade liberalisation is not a goal in itself, but should rather be regarded as a means, a complement to other development policies. The extended quote below illustrates how Rodrik's approach differs from the "Washington Consensus" view that trade liberalisation is virtually a goal in itself:

> *"The claims made by the boosters of international economic integration are frequently inflated or downright false. Countries that have done well in the post-war period are those that have been able to formulate a domestic investment strategy to kick-start growth and those that have had the appropriate institutions to handle adverse external shocks, not*

5 Publications in this context include Rodrik (1997), Rodrik (1998), Rodrik 1999 a) and b)), and Rodrik (2001).

those that have relied on reduced barriers to trade and capital flows. The evidence from the experience of the last two decades is quite clear: the countries that have grown most rapidly since the mid-1970s are those that have invested a high share of GDP *and maintained macroeconomic stability. The relationship between growth rates and indicators of openness – levels of tariff and non-tariff barriers or controls on capital flows – is weak at best. Policy-makers therefore have to focus on the fundamentals of economic growth – investment, macroeconomic stability, human resources, and good governance – and not let international economic integration dominate their thinking on development."*
(Rodrik 1999 a), p. 1).

2.2 International trade and certain specific development issues

In the discussion above, we have considered the theory of international trade in general, with emphasis on the special circumstances in low-income developing countries. Let us now round off this discussion with a few brief comments on more specific issues.

2.2.1 International trade, income distribution and patterns of growth

As stressed earlier, autarchy is not a solution for any country, large or small. For small, poor countries with a limited home market and little opportunity to diversify production, international trade is absolutely essential.

However, this answer is not enough to assess the effects of trade on income distribution and poverty in a country. That trade is good for poor countries is not the same thing as saying that it is good for all poor people. As previously noted there are most often losers too, just as there are large groups within the subsistence sector who are only marginally affected by what happens on the international trade front. The consequences of trade for the local population vary a great deal from country to country, depending on the type of trade concerned, and what type of growth – if any – is generated by this trade.

The static models of the effects of international trade on income distribution that dominate the literature indicate that these tend to be surprisingly small. As a rule, a reallocation of production in line with a country's static comparative advantages leads to, at most, a one or two percent rise in GDP and seldom to any major changes in income distribution. There are, however, always groups of "winners" and "losers". What is interesting is the dynamic effect.

A general, almost trivial, observation is that exports of industrial goods normally lead to higher growth in employment and poverty reduction than do raw materials exports. The fast growing countries in Asia have, without exception, based their growth on diversification and industrialisation with expansion on both their home markets and the world market.

Even when it comes to raw materials exports, there are major differences in their effects on poverty. Mineral exports have often proved to be linked to disadvantages from an income and employment – and environmental – point of view, and have often created a distorted economic structure including neglect of agriculture and an extremely uneven distribution of income.

Countries where revenues are predominantly based on one single profitable export product e.g. diamonds, copper or oil have, to a larger extent than other countries, seen political conflicts that ultimately result in an internal power struggle between different groups for control of this resource. LDCs such as Angola, Liberia or Sierra Leone illustrate this pattern.

Almost 70 per cent of the inhabitants of LDCs, and an even higher proportion of their people living in poverty, are employed in agriculture. If the beneficial effects of international trade are to reach the rural areas, small-scale rural activities must expand their production capacity, with a special emphasis on agriculture and ancillary industries such as trade, transport, small-scale processing etc.

Associated major investments in physical infrastructure are also needed in the poorest countries, along with agricultural extension services and new credit opportunities for rural populations. Or, put in another way: integration into the world economy may be a good thing, but a greater degree of integration of the domestic economies of these countries is also vital. International trade initiatives should never be seen as a substitute for other development initiatives but rather as a complement to them.

Liberalisation of trade can open up tremendous job opportunities and enhance the development of impoverished rural areas. This is especially true if agricultural land and resources are distributed so that small and medium-sized farms rather than large landowners are able to take advantage of this opening up of trade to export to profitable markets and gain access to imported investment goods. But a liberalisation of trade policy can also result in the country – or the capital city at least – being opened up for imports of subsidised food surpluses from the rich industrial nations while at the same time rural communities are becoming increasingly marginalised.

2.2.2 Trade and the environment with emphasis on LDC imports and exports

There are no simple links between trade and the environment, although all forms of transportation of goods entail a certain amount of pollution and emission of greenhouse gases. But trade has also the potential to benefit the environment by contributing to a more efficient use of resources, including natural resources, and by leading to economic development that could be used to improve environmental protection. If this is to happen in practice, however, various measures including more effective environmental policies must be pursued at national and international level. Tough environmental legislation is rare in the industrialised countries however, and even more difficult to find in developing nations.

Trade and international investments indirectly affect the environment in several different ways. They change both the pace and composition of economic growth and the technology used to achieve it. International trade agreements can also affect which rules and other policy measures are applied within environmental policies. The environmental effects of these various changes may be both positive and negative in individual cases. Specialisation in export production that is harmful to the environment, such as prawn farming, will naturally have totally different environmental consequences than specialising in the export of clothes or electronic equipment.

Trade in itself is rarely a cause of environmental problems, but it can magnify the effects of environmentally harmful processes. For instance, exposure to global demand for timber can amplify the effects of weaknesses in national forestry policies and legislation and result in forests being cleared destructively. One general conclusion is therefore that international trade intensifies the need for an effective environmental policy. At the same time, increased trade and investments can reduce a country's desire and ability to implement an effective policy of this kind. Despite the lack of empirical evidence, many governments in both the North and South believe that tougher environmental demands would "scare off" companies and investments.

LDCs are largely dependent on renewable natural resources such as land, forests and water, and non-renewable resources such as minerals, for both exports and the livelihoods of their populations. Consequently environmental risks arising from trade are especially large, and depleting natural resources for trade purposes will almost certainly backlash on the economy. At the same time, laws to protect the environment are notoriously weak as are the authorities that should enforce them. Case studies have shown that structural adjustment programmes in developing countries – which have included trade liberalisation – have hastened the exploitation of natural resources, whilst environmental protection agencies have, if anything, been weakened (Reed 1996).

These shortcomings in environmental protection in LDCs mean that international companies active in these countries, whether industrial manufacturing, plantation farming or mining, have a special responsibility to operate with a high degree of environmental concern. Some companies establish corporate-wide standards that apply to all their operations in all countries, irrespective of whether local legal requirements are less strict. There are however countless examples of companies who take advantage of the weak negotiating position of certain countries and their inability to enforce environmental protection demands. Sometimes they simply exploit the natural resources in an extremely short-term manner and then relocate their operations to another place or another country.

Around one third of LDCs are dependent on ore or *mineral* exports. The exports of several African countries in particular are totally dominated by mining. Ten of these countries export diamonds while oil is the dominant export in others (Angola and Congo), copper (Zambia) aluminium (Guinea) plus less common minerals such as cobalt, graphite and vanadium. Heavy metals and other elements, depending on what is mined, lead to widespread pollution of waterways. This and other emissions such as airborne pollution from further processing can have a substantial impact on the surrounding landscape.

Several LDCs are currently major *timber* exporters: Cambodia, Equatorial Guinea, Laos, Burma and the Solomon Islands. The forests in these countries hold tremendous biological diversity and, as in the entire tropical region, they are rapidly shrinking due to increased farming, logging for export, hydropower development and mining. In several LDCs, and in West Africa in particular, tropical rainforests have already been largely destroyed. In many countries logging and timber exports are riddled with corruption and illegal activities. According to investigations by the WWF (World Wide Fund for Nature) and others, up to one third of all felling in South East Asia is illegal (Axelsson Nycander 1999).

The majority of LDCs export primarily *agricultural products.* The major export crops are coffee, cotton, cocoa, tobacco, sesame seeds and cashew nuts. To a certain extent these are cultivated on large-scale plantations, but are also grown by small farmers. Pesticides and other agents that can cause long-term damage to both the environment and humans are often used on large plantations. Cotton, in particular, is heavily sprayed. Industrial farming methods have not reached many smallholders, however. Here erosion and the adverse impact on biological diversity from clearance of new farmlands can cause problems. Generally speaking, African soils are poor in nutrients and sensitive to erosion.

However, the absence of modern farming techniques can also have positive environmental effects, and even create economic opportunities (see Section 4.5 on new niches).

Agricultural exports affect the environment in many ways. Apart from the direct environmental impact of growing crops for export, there are also the indirect effects on land use (Reed 2000). In many cases an expansion of export crops results in subsistence farming being forced onto marginal lands, leading to further deforestation and increased erosion. A one-sided dependence on a small number of crops also leads to vulnerability to climate change, diseases and insect attacks.

In principle, it could be questioned whether the hard drive towards specialisation that is necessary for trade is compatible with ecologically sustainable farming, as the latter is based on adaptation to local conditions, crop diversity and the circulation of organic materials and nutrients (Einarsson 2000).

For ten LDCs (island states, plus a few Asian and East African countries) *fish or shrimps* are among the most important export products. Many of the fishing waters of these countries are threatened by overfishing, however it is seldom these countries' own fishing industries that pose the greatest threat. This is usually coastal and pursued on a small scale with relatively traditional methods. The real threat is from factory fishing vessels – from the EU and elsewhere. (See Chapter 13.4). There are also examples of small-scale fishing being carried out with environmentally harmful methods; for instance, some fishermen around Lake Victoria have used pesticides to catch fish. Shrimp farming, which has rapidly spread along many tropical coastal areas, causes major environmental damage by destroying mangrove swamps that act as "nurseries" for many sea fish. Ocean caught shrimps are also a source of concern as many endangered turtles are caught in the nets.

Clothes, the only industrial product that LDCs export in any great volume are, with the exception of Tanzania and Lesotho, only exported by Asian LDCs. Clothes manufacturing causes major environmental damage, but this mainly occurs in the early stages of the production chain – cotton growing, and the processing and dyeing of cotton and cloth. The actual sewing causes very few environmental problems. This is actually a type of production which causes unusually little environmental pollution, especially when examined in regard to the number of people employed in the activity.

Imports can have adverse environmental impacts, particularly when they lead to an environmentally damaging lifestyle being adopted by the more affluent sectors of the population. The effects are often immediately apparent in cases where countries lack the capacity to manage waste in an environmentally acceptable way when the goods have been consumed. The most extreme example of negative environmental impact is the trade in hazardous waste that took place in the early 1990s. Most of this trade has now been banned, however, in accordance with the Basle Convention, which prohibits OECD countries from exporting hazardous waste to non-OECD countries.

Naturally, imports can also make a positive environmental contribution, especially if modern, energy efficient and environmentally friendly technology is imported. However, once again, for this to occur, clear national policies are required.

2.2.3 Gender aspects of international trade

Although discrimination against women is a global phenomenon, available statistics suggest that women are especially vulnerable in the very poorest countries of the world. There are far more malnourished girls and women than there are malnourished boys and men. Only 46 per cent of women in LDCs are literate, compared with 76 per cent for developing nations in general, and the gap between the level of education for men and women is much higher in this group (see, for example, data on "gender gaps" in UNDP's *Human Development Report*). Countless studies also confirm that women have a much higher workload than men, and that women are substantially underrepresented in managerial positions in both the public and private sectors.

Trade can only be assumed to have a marginal affect on the deep divisions between the situation for men and women, at least in the short term. There is also a dearth of theoretical and empirical research on trade and gender issues. However, it is worth expressing a few words on the subject.

To begin with, agriculture is the most important source of employment for both men and women. With a few exceptions – such as Djibouti and some of the smaller island states – most people in LDCs are involved in farming. In the LDC group as a whole, agriculture accounts for close to 70 per cent of employment opportunities and 33 per cent of GDP.

The percentage of women involved in agriculture is even higher. In South Asia and sub-Saharan Africa over 70 per cent of women work in agriculture, and a majority of the farmers are women.

Generally speaking women in LDCs are responsible for staple crops for their own families while men look after the production and, above all, the sale of cash crops. When it comes to livestock, the standard pattern, at least in sub-Saharan Africa, is for women to look after the smaller animals such as hens and goats, and men the cattle.

Trade liberalisation can be expected to increase demand and prices for cash crops, and reduce the relative profitability of staple crops. A consequence of this could be that the "terms of trade" between male and female production and payment will change, to the detriment of women.

In many LDCs, restrictions – imposed either by law or by custom – on the rights of women to own or inherit land, obtain loans, etc. are common. A liberalisation of foreign trade which would open up new business opportunities for female farmers – who make up over two thirds of all farmers in sub-Saharan Africa – must therefore be supported by improving women's rights in these and other respects in order to achieve the desired effects on female earnings, and on economic growth in general.

The same is true for female employment in micro enterprises, not least within the so-called informal sector where women predominate. Easier access for women to credit, imported consumer goods, tools and inputs for craft and small-scale enterprises, marketing opportunities and the like, are vital if this major sector is to reap the benefits of increased import and export opportunities.

For many micro enterprises within e.g. textiles, food processing etc. that are almost always run by women, trade liberalisation has often led to overwhelming import competition and major marketing difficulties. Everyone who has visited a local market in an African LDC in recent years has been able to see the inroads imported goods – primarily manufactured in Asia – have made and how foreign clothes, shoes, household utensils and toys predominate. While this development has served to improve poor people's access to many consumer goods, it must also be acknowledged that a large number of work opportunities for women have been lost.

For the very few LDCs that have been able, like Bangladesh, to gain a niche foothold in the manufacturing industry – mainly in clothes and textiles, but also in toys, simple electronic components etc. – the pattern seems to be that female labour predominates in the export industry. This is also the experience of many other developing nations at an early stage in their industrialisation process.[6]

This creation of employment opportunities for women in LDCs is basically positive when it comes to female subsistence and equality. However it is important not to turn a blind eye to the hazardous working conditions that often characterise these industries, or "sweatshops", that are often found in so-called free zones where union rights, job security and a social welfare net are conspicuous by their absence.

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6 See for example UNCTAD, "Trade, Sustainable Development and Gender (1999), whose observations include: "Many countries have seen a dramatic increase both in export manufacturing capacity and in the number and share of women in the manufacturing labour force; the Dominican Republic, Indonesia, Republic of Korea, Mauritius, the Philippines, Taiwan Province of China, and Tunisia are examples. The stronger the concentration in exports of labour-intensive operations, such as production of clothing, semiconductors, shoes, sports goods, and toys, the higher the proportion of women tends to be" (pp. 22–23).

In the somewhat longer term, there are major opportunities for women even in poor countries to gain greater benefits from trade and the so-called globalisation process. The fastest growing sectors in today's world economy are not traditional male professions calling for muscle power but rather services of various kinds. The need for labour within the new service sectors – where female labour is usually preferred by employers – covers the entire spectrum from unskilled labour (such as cleaners at tourist hotels) to jobs requiring language and other skills (call centres for airlines etc) and highly qualified services within e.g. the IT sector or the financial sector.

2.2.4 Trade and child labour

The use of child labour has rightly offended many people. International campaigns against the sportswear company Nike, which has been accused of exploiting child labour, have been publicised the world over, as has the struggle of children in Pakistan against the virtually slave-like conditions in the local export-oriented carpet industry.

However, it is important to emphasise that only a very tiny proportion of child labour around the world occurs within the formal sector of the economy. An even smaller proportion – far less than five percent, according to experienced observers[7] – of child labour in developing countries is employed in the export-oriented sectors that have attracted the greatest international attention. The overwhelming majority of underage workers in poor countries are found in agriculture, household work (child minding, cleaning, fetching water and firewood, etc.).

Campaigns to condemn and prohibit child labour serve a valid purpose: to highlight the often inhuman conditions which children are exposed to through commercial exploitation and degradation. It is an important task for consumer and human rights organisations, and for unions, to inform the public and to protest against violations of international agreements that prohibit child labour. The International Labour Organisation's (ILO) eight core conventions, one of which prohibits child labour, have a major role to play here.[8]

It is desirable that both the ILO conventions and the UN Convention on the Rights of the Child should be treated more seriously by their signatory countries, and that they were more extensively respected and observed than they are today. However, the only solution in the long-term for those

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7 See e.g. a summary account of available research in Boyden/Ling/Myers (1998).

8 In addition to the ILO Convention on Child Labour there is also the UN Convention on the Rights of the Child (CRC). The latter has been signed by all but two countries: Somalia (an LDC) and the United States.

children forced to work today, and for their families, is to offer an alternative: meaningful schooling for the children and alternative sources of income for the families.

If international trade could create a better foundation for sustainable economic and social development and an improvement in education systems, then the issue of child labour could be successively reduced. This is of little consolation to children forced to work rather than go to school today, but there are no quick and easy solutions and it is doubtful if issues concerning child labour should be dealt with within the framework of WTO and international rules and regulations on trade.

2.2.5 Trade and foreign direct investment

Parts of the WTO regulatory framework – such as GATS, TRIPS and TRIMS – directly or indirectly address issues concerning Foreign Direct Investment (FDI). One example is that the principles that form the basis of both GATS and TRIMS severely restrict a host country's powers to impose terms and conditions on foreign investments with regard to issues such as the use of local labour and local content, demands that have historically been common in connection with FDI.

We will return to these issues at a later stage. The aim of this chapter is not to discuss WTO rules and regulations but rather to take a very brief look at the connection between FDI, trade and development.

Initially it can be clearly stated that the scepticism concerning the positive effects of FDI that used to surround the debate on foreign investment has now been superseded by almost universal agreement on the necessity of such investment in poor countries. There is not a single LDC today that does not claim to welcome foreign direct investment, especially within the export sector.

The most important motives stated for accepting foreign investment, and which also enjoy significant support in theoretical and empirical literature on FDI, are:

- the necessity of capital and foreign exchange for investment;
- positive effects on exports and employment;
- technology transfer via FDI;
- spin-off effects through increased competition, diffusion of modern management and marketing skills, etc.

As previously mentioned, the LDCs' share of total direct investments is currently very small: around 0.2 per cent of global direct investments, and barely 1.5 per cent of all direct investment in developing nations. In addition, over two thirds of the flow of FDI into LDCs has, in recent years, gone to a small number of countries with oil or gas deposits.

The weak power of attraction to foreign investors exhibited by LDCs is clearly related to their poverty and associated problems. Regular research and questionnaires on why transnational companies choose a particular location for direct investments always highlight factors such as political stability and stability in the legal and economic "rules of the game", access to skilled workers, physical infrastructure and rapid and reliable telecommunications. Wage levels in the country matter, as obviously do natural resources for manufacturing based on raw materials, but these are less critical than the factors mentioned above.

From this it follows that the hopes of many LDCs that a rapidly growing influx of FDI will solve their problems regarding access to capital and technology appear to be unfounded. As a rule, foreign direct investment outside certain natural resources such as oil or minerals only arrives when a country has reached a certain degree of political stability and economic development. Research into technology transfers and "spillover effects" of FDI[9] also reveals that the general level of education and competitiveness in the country (i.e. the presence of domestic industries within similar sectors) have a significant bearing on whether or not direct investment has a positive effect on technology transfer and productivity.

There are also obvious risks in being too dependent on FDI for investments and exports. Transnational companies have a wide choice of countries when considering the location of certain production, e.g. component manufacturing, in a low wage country and production can be relocated to another country at the slightest sign of political or economic instability. The creation of free zones, (often called "export processing zones"), which are reserved for exporters, can also give rise to what is sometimes called "social dumping", or "the race to the bottom". By wooing companies with tariff and tax breaks, restrictions on union rights and extremely low wages, various countries compete with each other to attract foreign investors. The foreign companies that do establish operations in free zones tend, as a rule, to be poorly integrated with the rest of domestic commerce and industry.

As an overall summary, it can be said that future foreign direct investment can have a very important role to play in helping the LDCs integrate into the world economy. Particularly within new niches in manufacturing

9 For a review of relevant research see, for example, *The World Bank Economic Review*, Vol. 14, No. 1, January 2000 (theme issue on trade and technology).

industry and trade in services, FDI can pave the way for increased exports and the transfer of new technology, including know-how related to business management, organisation and marketing. But ultimately it is up to the countries themselves to create a sufficiently attractive "environment" for investment – both domestic and international.

Growth, globalisation and world trade – general trends

CHAPTER 3

3.1 Patterns of growth

During the 1960s and early 70s, production of goods and services within the OECD group grew by an average of 4.0 per cent annually. During the 80s and 90s, annual growth fell to 2.9 and 2.3 per cent respectively. Still respectable, but in the rich industrialised countries there seemed to be clear signs of a successive decrease in economic growth.

The average rate of growth of just over two per cent per year in the OECD countries during the 90s concealed the major differences that existed between the three big blocs, illustrated by the fact that the extended boom in the USA from 1992 to 2000 coincided with a long, deep slump in Japan in the same period.

For the developing countries, the 1990s came to reinforce the tendency that was already clear in the 80s, namely a rapid and unparalleled rise in per capita income in Asia, where the "Asian Crisis" of 1997/98 seemed to be merely a blip on the curve. Development in Latin America was marked by a certain degree of stabilisation and modest recovery, while sub-Saharan Africa continued to endure stagnation or further decline.

The 21st century started with an international economic downturn as a consequence of, among other things, the bursting of a stock market and IT bubble and severe financial crises in a number of emerging economies such as Argentina and Turkey. Global growth recovered rapidly, however, and the years 2003–2006 have witnessed impressive rates of growth in virtually all major regions, including sub-Saharan Africa, and in particular in Asian and other emerging economies.

Table 3.1 below summarises growth of output in major regions from 1980–2005.

Table 3.1: Economic growth in the world 1980–2004 (average annual % change in constant prices)

GDP growth	1980–1989	1990–1999	2000–2004
World	3.3	3.2	3.8
Advanced economies	3.0	2.7	2.4
of which:			
European Union	2.1	2.1	2.2
United States	3.1	3.1	2.6
Japan	3.7	1.7	1.3
Emerging and developing countries	3.9	3.8	5.7
of which:			
Developing Asia	6.9	7.3	7.0
China	9.8	9.7	8.6
India	5.6	5.7	5.7
Latin America & the Caribbean	2.1	3.0	2.4
Africa (excl. Egypt)	2.6	2.3	4.2
Africa: Sub-Sahara	2.5	2.2	4.2
Middle East (incl. Egypt)	1.7	4.0	5.0
Central and eastern Europe (incl. Turkey & Malta)	2.1	1.0	4.1
Former Soviet States and Mongolia	3.5	-5.0	7.4
Least Developed Countries	2.6	3.5	5.5
Bangladesh	4.0	6.0	6.1
Bangladesh excluded	2.3	2.9	5.0

Sources: IMF, *World Economic Outlook Statistics*, web, April 2006, and World Bank, *World Development Indicators*, web, April 2006

With regard to world trade (see Table 3.2 below), development follows the overall pattern illustrated by Table 3.1. However international trade has increased considerably more rapidly than GDP in all major regions, and the proportion of the world's combined GDP that is exported has jumped from 17 to 25 percent between the early 1970s and 2004.

Table 3.2 below shows the development of merchandise exports of goods (in fixed prices) for various country groupings from 1982–2004.

Table 3.2: Percentage growth of exports (value) in major regions 1982–2004

Region/Time periods	1982–1989	1990–1999	2000–2004
World	4.8	6.7	6.4
Advanced economies	5.5	6.5	5.1
Emerging and developing countries	2.9	7.5	10.1
Of which:			
Developing Asia	7.4	12.7	13.9
Latin America & the Caribbean	4.5	9.3	5.7
Africa (excl. Egypt)	1.8	3.9	5.5
Sub-Saharan Africa	2.1	3.7	5.8
Middle East (incl. Egypt)	1.8	6.0	6.4
Central and eastern Europe (incl. Turkey & Malta)	2.9	7.5	10.9
Former Soviet States and Mongolia	3.6	-0.5	8.2

Source: IMF, *World Economic Outlook Statistics*, web, April 2006

The acceleration of the rate of growth of trade in emerging and developing economies at the beginning of the present century is striking. The non-OECD countries' share of global trade has increased from 20 per cent in 1970 to 43 per cent in 2005 (data from *The Economist*, "The New Titans", September 16th 2006). In 2007, China alone is expected to account for ten per cent of world trade, up from four per cent in 2000 (*ibid*).

The future implications of these dramatic shifts in global trade patterns cannot yet be assessed, but one likely consequence is that relative prices of a wide range of consumer goods from China and other Asian emerging economies will continue to decline on the world market while prices of oil, minerals and raw materials in general will probably increase. For a majority of LDCs this would imply an improvement in their terms of trade.

The development in LDCs is addressed in greater detail in Section 3.4 below.

3.2 Globalisation

Few economic or social phenomena have attracted as much interest and coverage in recent years as globalisation. Globalisation affects core issues within every conceivable area: culture, mass media, advertising, consumption patterns and life styles, financial markets, criminality – not least trade-related crimes such as the drug trade and trafficking[10] – political processes, social movements, the emergence of new networks and popular organisations, etc. Obviously this study is not the place to discuss all these disparate, but interconnected, phenomena; we may, however, make a couple of observations to help clarify a few issues important to the integration of the economies of the poorest countries into the world economy.

3.2.1 Technological and economic driving forces

The most powerful underlying driving force behind what we call globalisation is the development of technology that has enabled international communications to become faster and faster and, not least important, cheaper and cheaper. An illustration is provided in Table 3.3.

Spectacular developments within ICT (Information and Communication Technology) in recent years have led to further decreases in the cost of communications.[11] The marginal cost of sending e-mails and other information round the world is virtually zero, if there is access to Internet.

This technical and financial trend towards cheaper and faster communications appears irreversible, at least as regards the ICT-driven information revolution; political decisions can only have a marginal effect on the rate of progress in this respect. The costs of transporting goods and people are, however, also highly dependent upon prices of energy, and the coming decades may, or may not, witness a reversal of the 20th century trend illustrated in Table 3.3 above.

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10 We should emphasise that this study addresses legal trade only, although it is clear that illegal trade plays a large and probably growing role in many countries, not least in the very poorest.

11 One exception, however, is postage in Sweden, which has increased more rapidly than the consumer price index. The fact that it is now more expensive to send a letter from a Swedish town to Stockholm than to send a letter to Stockholm from Kathmandu, for example, opens a niche for postal services in poor countries, and certain companies and organisations have already started to post high-volume mail-shots from poor countries.

Table 3.3 Declining costs of transport and communications (1990 USD)

Year	Sea freight	Air transport	Telephone call
	(average ocean freight and port charges per ton)	(average revenue per passenger mile)	(three minutes New York/London)
1920	95	–	–
1930	60	0.68	245
1940	63	0.46	189
1950	34	0.30	53
1960	27	0.24	46
1970	27	0.16	32
1980	24	0.10	5
1990	29	0.11	3

Source: UNDP, *Human Development Report 1999*, p. 30, based on data from the IMF.

3.2.2 The growing role of financial markets

The global financial market is one of the sectors that have gained the greatest benefits from this explosive communications development. Turnover on the world's currency markets has grown exponentially in recent decades and is now estimated at well over USD 2,000 billion per day, or around ten times the annual GDP of all the LDCs combined.

The LDCs, naturally enough, play a very marginal role in these global financial markets. The inflow of private capital to LDCs has, as mentioned earlier, remained insignificant. Nonetheless, the numerous financial crises of the 1990s have clearly shown that even the very poorest countries are affected by unrest on global financial markets. For example, a large number of low-income countries suffered in the 90s from the "contagion" of crises in Asia, Latin America and Russia in the form of financial turbulence, capital flight, interest rate rises and pressure on local currencies. Many of the countries that had liberalised their foreign exchange and capital markets were especially hard hit.

Greater financial vulnerability can now be included alongside the LDCs' traditional vulnerability to fluctuating prices on the world commodity markets.

3.2.3 Globalisation: key actors

The move towards greater integration of world markets for goods and services that has been briefly addressed above has its roots in technological and economic developments that have caused the world to shrink and economies to become increasingly globalised. There are also a number of key players behind the globalisation process, the most important of which are the large transnational corporations who not only act globally within their respective spheres, but also put pressure on governments and international organisations to accelerate globalisation.

Various international organisations are also found amongst these influential players. The most important of which, in recent decades, have been the IMF and the World Bank who have played a decisive role in hastening the liberalisation and deregulation of the economies of the poorer countries of the world. During the 1980s and 90s a large majority of today's developing nations had agreements on economic policy with the Bretton Woods institutions. The conditionality that marked these agreements was to all intents and purposes based on the "Washington Consensus" briefly discussed under Section 2.1.4.[12]

Other international organisations that can be considered important players in this context are the WTO, which we will look at in greater detail in later chapters in this study, and the rich industrialised nations' cooperation and development organisation OECD, which continuously urges its member countries to pursue further deregulation and liberalisation.

Behind these organisations stand governments, principally the governments of the dominant industrialised countries. These have, almost without exception, supported the movement towards more liberalised world trade and the abolition of individual country's foreign exchange restrictions and capital controls that have characterised recent decades.

3.2.4 The implications of globalisation for world trade

As issues concerning globalisation and the integration of the poorest countries into the world economy will be a recurring theme throughout this study, there is no need at this stage to go any deeper into the globalisation debate. However, we intend to make a few general comments at this point.

From the point of view of foreign trade the falling costs of communications combined with political decisions on reduced tariffs and trade re-

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12 Naturally there are clear differences – concerning e.g. mandates and types of conditionality – between the IMF and the World Bank, not least as the Bank has retreated from several of its earlier positions. In the structural adjustment programmes of the 80s and 90s, however, the similarities were substantially greater than the differences when it came to conditionality and principles of economic policy; hence the expression "Washington Consensus" (a consensus that was often taken to include the US Government as well).

strictions will make cross-border trade easier. Geographic location will play an ever less significant role in those areas of the world that have access to modern and inexpensive communications (unless higher oil prices reverse the long-term trend towards lower and lower costs of transportation).

The classic competitive advantage "proximity to the market" has therefore become less and less important.[13] For certain types of trade, e.g. a growing section of the trade in services which is based on the exchange of information via the Internet, geographical distance is already virtually irrelevant. In addition, the fact that the size of the domestic market plays an ever-decreasing role would seem to favour the LDCs; it has today become possible to make a direct entrance onto the world market without first having had to develop production for the domestic market.

For the large transnational corporations who are spearheading the globalisation process, developments on the communications front have turned the entire world into their playing field. Geography plays an increasingly subordinate role when it comes to corporate decisions on locations and sub-contractors. Nike trainers or IKEA furniture, for instance, can be manufactured in Estonia, Indonesia, Romania, the Dominican Republic or Vietnam; the distance to market is less important than factors such as reliability in terms of quality and delivery times, wage levels, political stability, reliable communications, tax polices in the host country, etc.

There are, however, a number of exceptions to the trend towards ever cheaper communications. In many poor countries, domestic communications are slow and expensive, and it is often cheaper to send goods – and information – from the capital city to Europe than to rural areas 100 kilometres away.

The same is true for imports; it is often cheaper to ship grain to the capital from Europe or North America than from surplus farmers in the country itself.

Consequently while the capital cities of the world are moving closer and closer, rural communities in poor countries risk becoming increasingly marginalised in the international division of labour.

Even so, the globalisation process is opening up new opportunities for the extremely poor countries too, not least within the service sector. The implications of this for the LDCs will be discussed at a later stage in this study.

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13 This applies primarily to actual production. In other respects – e.g. research and development – being close to excellent research environments is important; we see here more of a tendency to a greater concentration into centrally located high-tech clusters such as Silicon Valley. The ever-faster rate of change in product development, design etc. also requires closeness to markets, and sensitivity to changes in fashion.

3.3 The LDCs in world trade: an overview

Global trends in trade have been briefly addressed above. We intend to provide only a rough outline here. For more detailed information on the most important export goods from LDCs, see the chapters on textiles and agriculture (Chapters 9 and 10, respectively) and Annex 2. Suffice it here to indicate that the LDCs' share of world trade has successively fallen over recent decades – from over two percent in the 1960s to half a per cent today. Their share of world trade in commercial services is even lower, around 0.4 percent, and what little trade in services they do have is dominated by tourism (see Chapter 11).

To illustrate just how marginal the LDCs are to the world economy, at just over BUSD 57 the total value of their exports is less than half of that of Sweden alone.

Where the most important export products are concerned, virtually all LDCs – with the exception of Bangladesh and a couple of countries in Asia and the Pacific – have failed to diversify their exports. Raw materials, and more or less the same raw materials as twenty or thirty years ago, continue to predominate. This pronounced concentration on a very small number of commodities is illustrated by the fact that the three most important commodities in each LDC account for 76 percent of the total value of their exports (LDC *Report 2004*). Raw materials make up less than 80 percent of exports in only five LDCs – Bangladesh, Laos, Cambodia, Myanmar and Madagascar.

As raw materials are generally exported in an entirely unprocessed state, the producing countries receive only a small and shrinking share of the value of the final product, as the subsequent stages – refining, processing, packaging, advertising, marketing, distribution etc – account for a successively growing proportion of the ultimate sales value.

An overview of the most important export products for individual LDCs can be found in Appendix 2. Table 3.5 summarises the most important export goods for LDCs as a group.

Table 3.5 clearly illustrates that the LDCs have a very small share of virtually all product categories (however they do have a larger share of other, slightly unusual products such as sesame seeds and cashew nuts and in certain smaller textile niches). Spices and cotton are the only major product categories in which the LDCs have a combined share of the world market over or around ten percent.

It is also worth emphasising that the dominant export products in most non oil-exporting LDCs can be found in stagnating world markets, i.e. markets where growth in demand has been poorer than for world trade as a

Table 3.5: Most important export goods of LDCs (2003)

Product	Value (millions US$)	Share of LDC export	Share of world export
Petroleum, crude	13 178	33.4	3.4
Clothing products	7 763	19.7	1.1
Petroleum, other	2 716	6.9	0.9
Shell fish	979	2.5	5.4
Wood products	872	2.2	1.4
Cotton	839	2.1	9.3
Gold	741	1.9	2.4
Textile products	787	2.0	3.5
Gas	727	1.8	0.7
Pearls	726	1.8	1.2
Fish	682	1.7	1.5
Copper	584	1.5	1.8
Aluminium	485	1.2	0.9
Coffee	446	1.1	4.6
Spices	320	0.8	11.5
Tobacco	406	1.0	1.2
Leather	274	0.7	0.5
OTHER	6 348	17.7	
TOTAL	*39 494*	*100*	*0.53*

Source: UNCTAD, *Handbook of Statistics*, June 2006.

whole. The last few years' increase in demand and prices of raw materials may, however, change this pattern, in particular for exporters of oil and minerals.

With regard to the major LCD trading partners, we have seen an encouraging rise in south-south trade in recent years (see Chapter 14). Today developing countries receive 41 per cent of LDC exports.

The EU is the most important single market for the LDCs, taking around 28 per cent of their total exports by value. On the import side, the EU accounts for 27 percent and USA and Japan for six and close to four percent respectively, of LDC imports. China and other Asian countries are likely to continue to rapidly increase their share of LDC trade.

Trade policy reforms and export opportunities in LDCs

CHAPTER 4

It is difficult to make generalisations about 50 heterogeneous countries whose only common link is that they are classified as LDCs. As such, we are aware that observations in this and other sections will not be true for all LDCs and our comments are, as a rule, more relevant to the poorest countries in sub-Saharan Africa than for e.g. Bangladesh or the tiny island states of the Pacific.

Trade policies of most LDCs up until the beginning of the 1980s were strongly protectionist, and characterised by more or less pronounced import substitution strategies. Then, as previously mentioned, the debt crisis and structural adjustment programmes, as well as widespread dissatisfaction with the fruits of past policies, led to a period largely characterised by liberalisation and deregulation, including more liberal trade policies.

There are different ways of measuring the degree of protectionism, but none of them is very accurate. The most commonly used gauge – the level of a country's tariffs – often reveals rather little about the nature of a country's trade policies. For example, a country can give a very "open" impression if it levies low tariffs on goods that the country does not produce at all, but high tariffs on a small number of goods where there is competition from domestic suppliers. In many developing and industrialised countries there is also a variety of non-tariff trade barriers in the form of quotas, licences and bureaucratic formalities that constitute barriers to trade.

A protectionist approach can also be pursued with the aid of exchange rate policies. A severely undervalued currency (rarely the case in LDCs, however) discriminates against imports.

4.1 Trade policies liberalised in most LDCs

Bearing these reservations in mind however, there are many indicators that show that trade policies have been liberalised in the majority of LDCs since the early 1980s. In sub-Saharan Africa, the average tariff rate is estimated to have fallen by between 30 and 50 percent between the mid 80s and beginning of the 90s (Oyejide, December 2000, p. 10). The 1995 World Bank report on Africa observed that *"...the greatest progress has been achieved in replacing quantitative restrictions with lower and less dispersed tariff levels; more than half of the countries now have average tariff rates of 15–20 per cent with the highest rates set at 35–40 per cent and the number of tariff categories reduced to 4–5"* (World Bank 1995, p. 24).

The period after the creation of WTO has witnessed continued reductions in the overall level of tariff protection. Between 1994 and 2005, tariffs on virtually all products in all regions were reduced substantially, but more in developing than in industrialised countries. By 2005, a weighted average of developing country tariffs had been brought down to only about five per cent (for more data on tariffs in developed and developing country markets, see Chapter 6).

Another expression of greater openness is the growing share of foreign trade in the GDP of the poorest countries. Table 4.1 below reflects this development.

Table 4.1: Exports plus imports as a percentage of GDP in different regions 1975–2004.

Region	1975	1985	1995	2000	2004
World	33	38	42	49	48
LDCs	29	33	46	52	54
East Asia & Pacific	21	33	59	68	82
Europe & Central Asia	..	..	64	80	84
European Monetary Union	46	59	57	73	71
Latin America & Caribbean	24	28	38	42	49
Middle East & North Africa	73	45	56	54	67
South Asia	16	17	27	31	41
Sub-Saharan Africa	56	54	60	64	66
China	*9*	*24*	*44*	*44*	*65*
India	*13*	*13*	*23*	*29*	*42*

Source: World Bank, *World Development Indicators*, web, April 2006

Developments in the latter half of the 1990s and early 21st century have, if anything, hastened trade liberalisation in the LDCs. One reason for this is that a number of poor countries have actively sought to become members of, or at least develop closer ties with, the WTO. WTO rules and regulations place great emphasis on "tariffication" even in the poorest countries, i.e. a transition from quotas and quantitative restrictions to more general and transparent tariffs. A large number of LDCs made long-term commitments towards liberalisation as early as during the Uruguay Round.

An even more vital driving force behind liberalisation was probably the structural adjustment programmes that the majority of LDCs – 34 of 50, and virtually all African LDCs – implemented to a greater or lesser extent, and more or less reluctantly, during the 1980s and 90s.

It is worth emphasising here that conditionality from the IMF and the World Bank – and frequently even from bilateral ODA donors – in these programmes have normally been far tougher and more binding than WTO demands. As we will discuss at a later stage, the LDCs that are members of the WTO have been granted various kinds of exemptions from, for example, WTO demands for lower tariffs and trade liberalisation. Conditionality in connection with structural adjustment programmes has been of a different, and in general more mandatory, nature.

Another importance difference is that the IMF and the World Bank control funds, which the WTO does not. The IMF and the World Bank also have a great influence in issues of debt relief. Breaking WTO rules is not too costly for the poorest countries compared with rejecting demands for liberalisation linked to agreements with the IMF and the World Bank.

A summary of trade liberalisation in the LDCs as a result of structural adjustment programmes in the 1980s and 90s is given in UNCTAD's "LDC Report 2000". Somewhat surprisingly perhaps, UNCTAD draws the conclusion that trade liberalisation as a result of structural adjustment and IMF/World Bank conditionality in the 1990s progressed further in the LDCs than in developing nations generally:

"As a consequence of these reforms, the policy environment in many LDCs changed significantly in the 1990s. IMF data actually shows that trade liberalisation has proceeded further in the LDCs than in other developing countries. In 1999, for 43 LDCs for which data are available, 37 per cent had average tariff rates below 20 per cent coupled with no or minor non-tariff barriers, whilst amongst the 78 other developing countries in the sample, only 23 per cent had this degree of openness. Indeed, 60 per cent of the 43 LDCs had average tariff barriers which were below 20 per cent and non-tariff barriers which were moderate in the sense that they were not pervasive, covering less than 25 per cent of production and trade. Similarly, UNCTAD data for the late 1990s show that, in a sample of 45 LDCs, only 9 maintained strict controls on remittances of dividends and profits and capital repatriation. Twenty-seven LDCs have adopted a free regime, guaranteeing such transfers, whilst nine have a relatively free regime." (LDC Report 2000, p. vi).

The above observations are further supported by the analysis in UNCTAD's *Least Developed Country Report 2004*, which concludes that "the LDCs have undertaken greater trade liberalisation than other developing countries" (p. 179). Using the IMF's index of trade restrictiveness, UNCTAD concludes that most of the LDCs have undertaken more extensive trade liberalisation than the large industrialising Asian and Latin American economies, and the IMF index on trade openness is exactly the same as the average for the EU, United States and Japan. Anther interesting conclusion is that among the LDCs there has been greater trade liberalisation in the African LDCs than in those in Asia, and also in the commodity-exporting LDCs than in the manufactured goods and/or service-exporting LDCs (ibid, pp. 180–181).

The declining share of exports from LDCs in general, and from African LDCs in particular, can hardly be blamed on lack of trade liberalisation.

4.2 Some underlying causes for LDCs' declining share of world trade

One simple conclusion to draw is that the LDCs' shrinking share of the world market over the past two decades is less to do with failings in trade policy liberalisation in the poor countries themselves, but rather with other types of problems that we will return to, namely:

- *Supply constraints* and weak economic growth in general (Chapter 5). That this is clearly the most important reason for stagnating trade development in LDCs is highlighted by the fact that the LDCs have more, and more generous, preferential trade agreements than other developing countries and yet despite this they are still far less successful in exporting.
- *Unfavourable price developments* for the majority of LDC products (which are sometimes linked to market restrictions).
- *Market restrictions* in the (few) areas where the LDCs are competitive. Before 2005, when the Multi-fibre Agreement (MFA) was abolished, the world market for textiles and clothing was severely restricted and ruled by a complicated system of quotas. When the MFA was finally abolished,

> China took over a large part of this market from several LDCs (see Chapter 9). On another market of special interest to many LDCs, agricultural products, certain restrictions on market access to the OECD countries remain (see Chapter 10). Other destructive protectionist trade barriers – which, however, primarily affect non-LDC developing countries – include the existence of tariff peaks, i.e. extra high tariffs on individual goods (such as sugar for example) which developing nations can produce at lower cost than industrialised countries. In addition the extremely damaging tariff escalation, where the higher the degree of processing of a product, the higher the tariffs levied. In concrete terms this means higher tariffs on, for example, roasted coffee than unroasted and very high tariffs on jam and marmalade but no tariffs at all on tropical fruits, i.e. extremely high punitive tariffs on the manufacturing process itself in poor countries. (See also Chapter 8).

Another element of the trade policies of industrialised countries which makes it much more difficult for poor countries to exploit the opportunities presented by the various preferential agreements in place are the *rules of origin*. These are used to determine if the exporting country has the right to preferential market access in those cases where part of the manufacturing process has taken place in a country other than the exporting country. These restrictions also affect LDCs with duty-free access to OECD markets when, as is often the case, inputs from non-LDCs are used in the production process (see further Chapter 13).

With the EU's introduction of EBA ("Everything but Arms"), which is further discussed in Section 6.2 below, almost all tariffs on LDC exports were abolished, however with EBA less favourable rules of origin were introduced as compared to the Cotonou rules.

4.3 Trade liberalisation problems in LDCs: tariffs and government revenue

One problem connected with trade liberalisation in the poorest countries is that many of them remain heavily dependent on import tariffs as a source of government revenue. On average, tariffs and other trade-related taxes and duties account for some 25 to 30 percent of the income side of government budgets in African LDCs. This figure is far higher than the average for other developing nations and naturally for industrialised countries, where tariffs now make an insignificant contribution to government revenue.

In many low-income countries with a poorly developed tax base, tariffs and trade-related duties are a relatively easy way of financing government spending as compared with alternative sources of income. The effects on income distribution are not unequivocally negative; rather the opposite, as the import intensity, i.e. the proportion of income spent on imported goods and services, is much higher in the urban middle class than among the rural poor. Alternative ways to raise revenue, such as the increasingly common Value Added Taxes (VATs), often mean that a comparatively heavier tax burden falls on low-income groups.

For these and other reasons there is often strong political opposition to import tariff reductions. Naturally, there are also instances of more dubious motives, related to corruption and "rent-seeking".

Tariffs and quantitative import restrictions are often due more to historical chance and powerful pressure groups than are related and subordinate to the country's development policy in general. Stimulating imports with the help of a selective trade policy with differentiated tariffs, e.g. inputs for small-scale farmers or to labour-intensive small industries, can be excellent complements to a development strategy aimed at job creation and poverty alleviation. However, the actual pattern is often exactly the opposite: e.g. subsidised foodstuffs are imported duty-free from the EU or the US which adversely affects domestic agriculture but makes food cheaper for city dwellers. Other examples include tariff-free imports of capital goods that stimulate the use of capital-intensive technology in domestic industry.

In many LDCs, a large proportion of imports are financed with ODA which can create major problems for trade and development policies. As donors are unwilling to have their ODA or credit-financed exports subjected to tariffs, the domestic price and cost structure risks becoming (further) distorted and non-ODA financed activities then experience difficulty in competing.

A concern more pressing than further tariff cuts to many LDCs is how to make the entire import system more efficient; this is largely what the WTO discussion about trade facilitation is concerned with (see further Chapter 15). Many poor countries have particularly inefficient and bureaucratic (and sometimes also corrupt) procurement procedures. Accelerating the release, clearance and physical movement of goods, including goods in transit, is also imperative. Improvements in these respects, and an overhaul of the tariff structure from a development perspective, may be more urgent than a general liberalisation of trade and ODA for efforts of this kind can bring many benefits.

It is important in this context to once again emphasise that a development policy that promotes trade is by no means synonymous with trade liberalisation. Liberalisation of trade may stimulate both imports and exports, but export-led growth requires much more than lower tariffs and reduced trade barriers.

4.4 Debt and financing issues as obstacles to trade in LDCs

Recent decades have brought stagnant or even reduced access to foreign exchange for the majority of LDCs. This has severely restricted their opportunities to import goods and to finance investments necessary for exports. As a consequence of the critical debt situation, financing of trade has also become more difficult (see Section 5.1.5).

The combination of falling export prices and low growth of export volumes has, as previously mentioned, meant that export revenues for LDCs grew very slowly during the 1980s and 90s. This was especially true for the African LDCs.

The same is the case for the inflow of finance in the form of ODA, credits and direct investments. Table 4.2 shows, in extremely aggregated terms, the inflow of finance to LDCs between 1980 and 2004.

The inflow of capital to LDCs can be compared with exports. In 2003 total export revenues for LDCs amounted to just over BUSD 46, while the inflow (gross) of credits, ODA, export credits and other private capital amounted to 28 BUSD. Or, put another way: around 62 per cent of the foreign exchange available to the LDCs came from their own exports – the rest from ODA and other forms of capital inflows (excluding private remittances, which represent a large and rising share of foreign exchange earnings for many LDCs).

Table 4.2: Financial flows to LDCs, 1985 – 2004. Current USD

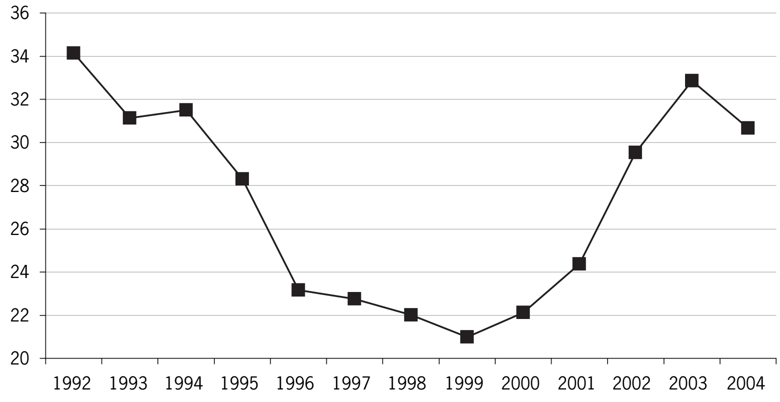
Financial flows	1985	1990	2001	2003	2004
Concessional loans & grants	9 503	16 752	13 838	23 791	24 908
Non-concessional flows (FDI, export credits, etc.)	430	737	1 355	4 205	1 742
Total financial flows	9 933	17 489	15 193	27 996	26 650

Source: UNCTAD, *LDC Report 2006*, p. 330.

As illustrated by the table above, a weak but positive trend can be detected in the area of non-concessional finance, including foreign direct investment (FDI). However, FDI is very unevenly spread amongst the LDC group: in 2004, oil and gas extraction in three countries (Angola, Sudan and Equatorial Guinea) accounted for around 50 percent of the flow of foreign direct investment to LDC countries, and for about 40 percent of the total stock of FDI.

In per capita terms, the total inflow of capital to the LDCs has fallen from USD 34 to in 1992 to USD 30 (in 2003 prices). Cutbacks in ODA follow a similar pattern: a decline from USD 34 per capita in 1992 to 21 in 1999 and 31 in 2004. This can be compared with the promises of sharply increased ODA levels made at various LDC conferences and other international meetings.

Diagram 4.1. ODA per capita to LDCs (constant 2003 USD)



Source: OECD, *International development statistics*, web May 2006.

As a result of all the different factors outlined above, the foreign debt situation tended to worsen during the 1990s (as was also the case in the 1980s). The nominal value of the LDCs' foreign debt rose from 121 to 162 BUSD between 1990 and 2004. This latter figure is the equivalent of three times the value of their total exports in 2004. Expressed as a percentage of GDP, the foreign debt burden rose from 92 to 101 percent between 1990 and 1998. In recent years the corresponding figure has fallen however and in 2004, the foreign debt/GDP ratio had declined to 64 percent.

According to the standards agreed within the HIPC initiative (Heavily Indebted Poor Countries), the debt burden in 27 of the 42 LDCs for which we have reliable data was "unsustainable" in the late 1990s. If the small island states are excluded, over two thirds of LDCs were said to have debt levels that were "unsustainable" according to HIPC criteria.

Recent initiatives, in particular the promises given at the G8 meeting in Gleneagles, Scotland in 2005 to cancel all debt to the IMF, the World Bank and the African Development Bank for the most heavily indebted, low-income countries qualifying for the HIPC debt cancellation programme, have improved the debt situation considerably for a number of countries. However serious problems about who is going to pay have arisen, and it is far from clear if – and when – these G8 commitments will actually be fulfilled. What does appear clear, however, is that virtually all debt relief to the international financial institutions will be paid from the aid budgets of the bilateral donors, thereby decreasing amounts available for ordinary ODA.

As concerns debt servicing, i.e. the amounts countries pay in interest and repayment on their foreign debts, this has remained relatively stable at around three percent of GNI annually since the 1970s, which corresponds to about BUSD 6.9 in 2004. Around one third of annual ODA (including concessional credits), or one eighth of annual export revenues, can thus be said to have been used for debt servicing. Hopefully, this figure will decrease in the future, when more substantial debt reductions have been carried out.

Appendix 2 includes a summary of the foreign debt situation of each LDC.

4.5 Future export opportunities for LDCs: traditional areas and new niches

Naturally it is impossible to "pick the winners" when talking about future export products from LDCs. Incredibly rapid developments, particularly in the services sector, are constantly opening up new opportunities even for the poorest countries to capture a share of the world market, and we will illustrate this with specific examples in subsequent chapters.

LDC exports will probably continue to be dominated by traditional raw materials for a long time to come, and a best-case scenario would be a reform of agricultural policies in the industrialised countries which would stop state-subsidised dumping, thereby stimulating import substitution of basic foodstuff on the developing countries' domestic markets as well as creating greater export opportunities. There are also encouraging signs that indicate that world market prices for a large number of agricultural products – and of course for minerals – are entering a more positive phase, after the period of extremely low prices in the 1980s and

90s. However, remaining trapped in today's one-sided export structure is not a genuine long-term solution to the problem of development for these countries. Even if commodity exports were to enter a period of higher world market prices, as occurred in the 1970s, maintaining the current natural resource based comparative advantages would be a dead end street for most LDCs. A lasting solution must be based on a diversification of exports, and improved opportunities for further processing of export products.

It is against this background that several of the market obstacles that have been briefly addressed above – problems associated with rules of origin, tariff escalation, tariff peaks and non-tariff barriers to trade – become especially significant and harmful.

It is also important to find niches that, although small in global terms, can offer great opportunities for certain LDCs. We have chosen to illustrate this with organic products, and to demonstrate opportunities of obtaining higher revenues from existing resource bases.

4.5.1 New niches for LDCs – the example of organic products

The current world market for organic products is approximately USD 30 billion (ITC, *International Trade Forum* no. 2/2006), corresponding to an annual growth of about 20 per cent since 1997. The EU-15 alone accounts for 50 percent of the world market. Around 15 percent of these organic products are traded internationally and grain, coffee, tea and cotton are the most commonly purchased products. Organic products provide producers with a premium that varies tremendously depending on the market and product. A 20–25 percent mark-up is not unusual.

NGOs at all levels are drivers of organic agriculture, from the International Federation of Organic Agriculture Movements (IFOAM) that sets standards and promotes the sector at an international level to local NGOs working with farmers' organisations.

Many farmers in the LDCs who have never converted to modern farming methods have an excellent opportunity to farm organically. Switching production is not so very taxing if you have never been able to afford pesticides or fertilizers anyway, and these farmers have often continued to use the old hardy strains and still know how to minimise insect attacks and enrich the soil using natural means.

The greatest obstacle to a rapid increase in the export of ecological products to markets in the North – where there is a chronic shortage – is the lack of an advanced and expensive infrastructure in the form of laboratories and other equipment for the inspection and certification of production. These obstacles are exacerbated by the requirements stipulated in the SPS Agreement (see Section 8.4) and by additional regulations introduced by the EU and other major import markets.

It is worth noting that about a dozen LDCs already export organic produce to the EU despite different constraints. These exports are relatively more diversified than other farming exports and even include fresh fruit and vegetables, which are relatively profitable crops. The quantities exported are small today, but have growth potential.

Foreign trade and domestic factors

CHAPTER 5

There are two types of obstacles that restrict LDC participation in world trade: problems related to market access, i.e. tariff and non-tariff trade barriers on export markets, and domestic factors that limit production and competitiveness. For the sake of simplicity, we can call these external trade barriers and internal trade barriers, even though we are aware that in certain areas, e.g. the financing of exports and imports, problems can be both of an internal and external nature.

External trade barriers have been briefly touched upon earlier and will be dealt with in later chapters. This section aims to summarise a few of the most important internal barriers which prevent more active participation in world trade. As usual, it is difficult to make generalisations about 50 different countries, and this discussion will probably be most relevant to the African LDCs.

It is also worth emphasising that the factors that restrict a country's participation in world trade are mainly the same as those that lie behind a country's general economic stagnation. If a country is to be a successful exporter and attractive trade partner, various preconditions must be fulfilled and various types of constraints removed. Below is an examination of some of the decisive factors in a country's ability to be a successful trading nation.

5.1 Internal factors facilitating trade

5.1.1 Political and institutional factors

The significance of "good governance" and the quality of a country's public institutions has gained increasing prominence in development theory discussions in recent years. "Good governance" embraces a wide range of aspects related to how governments exercise power at both central and local level, such as:

- a democratic society that enables a functional interplay between state, market and civil society;
- sound macroeconomic policies;
- stable rules of the game in business and everyday life;
- a credible, predictable and honest legal framework;
- a public sector that is reasonably efficient and uncorrupted;
- "accountability"; power holders are held accountable for their exercise of power.

As a whole, LDCs can be said to display major failings in most of the above, although great improvements have been made in many countries in recent years. Political instability and even armed conflicts have been commonplace in many LDCs, especially in Africa, and few LDCs can be said to boast well functioning democracies. Many LDCs have undergone dramatic political changes, with frequent shifts in leadership, economic policy, etc. Corruption is often rife. As a rule "accountability" is feeble, and the heavy dependence on ODA, foreign loans and international financial institutions in many countries has meant that the accountability of a regime has often been directed towards foreign donors and financial institutions rather than to the local population. For instance in many LDCs, ownership of the structural adjustment programmes of the 1980s and 90s, and later of the various Poverty Reduction Strategies (PRSs), has been very tenuous and the same is also true for many trade policy reforms and agreements.

It should also be added that many of the institutions required in a mature market economy – associated with well-defined property rights and a well-functioning legal system, financial instruments, statistics and information systems, independent and reliable mass media, etc. – are poorly developed in the poorest countries of the world.[14]

Where specific trade-related institutions, rules and regulations are concerned, a great deal could be done to make the administration of both imports and exports simpler and more efficient. Despite the substantial political reforms implemented in the area of trade which were briefly addressed in the previous chapter, foreign trade is still snared by complicated and inefficient legislation and administrative regulations concerning e.g. import controls, tariff administration, export taxes etc.

The most urgently needed domestic trade policy reforms in many LDCs today are not further tariff reductions but rather "trade facilitation" to use

14 UNCTAD's *LDC Report 2006*, Chapter 6, contains an interesting analysis on institutional weaknesses, not least weaknesses related to inadequate domestic financial systems, underdeveloped markets and lack of formal market institutions to support private sector activities.

the current WTO language, i.e. reforms aimed at reducing opportunities for arbitrary administration and corruption and to simplify regulations and make them more transparent.

5.1.2 Human capital

Development theory discussions have long taken as read that human capital is more important than, say, natural resources. Those countries that have been the most successful in terms of development in recent decades are countries that have invested in education and healthcare rather than exploiting rich natural resources.[15]

Singapore is an excellent illustration of this. A country with no natural resources to speak of and a population of slightly more than four million, today exports over three times as much as all LDCs combined. There are many different factors behind Singapore's success story and other similar stories, but the most important of all is the high level of education and the quality of the countries' institutions.

Many LDCs, not least in Africa, are rich in natural resources and could be called rich countries with poor people. Irrespective of what indicators we choose for human capital – average life span, calorie intake, level of education, gender equality or some other indicator – LDCs trail far behind the average for poor countries; it is actually this situation that makes them LDCs.

Although the significance of human capital is obvious for economic development in general, it is also worth noting that foreign trade often calls for specialist know-how. As such, certain skills – such as languages, international experience, ICT know-how etc. – are becoming increasingly important in today's globalised world.

5.1.3 Physical infrastructure

A few years ago, when the LDCs were asked to complete a questionnaire ranking the most important internal barriers to trade, two factors dominated their answers: shortage of human resources and poor physical infrastructure, including inadequate and unreliable power supply.[16]

The infrastructure failings that were emphasised in this questionnaire included a number of well-publicised problems: poor road networks and costly transport, expensive and unreliable road, sea and air connections,

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15 A number of studies have even established a significant negative correlation between a country's access to natural resources and its economic growth in recent decades. One of the main explanations of this phenomenon is that these "rich" countries have suffered more serious internal conflicts than less well-endowed countries.

16 See WTO, Sub-Committee on Least-Developed Countries, "Market Access for Exports of Goods and Services of the Least-Developed Countries: Barriers and Constraints", Geneva, December 1998.

inadequate storage capacity, etc. Prominent amongst these obstacles was all forms of domestic transport – as mentioned earlier, it is often simpler and cheaper to buy food from industrialised countries than from the country's own farmers.

There is also an enormous gap between the rich and poor countries in the increasingly important area of information and communication technology, ICT. The so called "digital divide" that separates countries and people that are "connected" from those that are not is shrinking in the fast-growing Asian industrialised countries, but for the majority of LDCS the digital divide between them and the rich countries is still widening.

It is sometimes alleged that the majority of people in LDCS have never even used a telephone. Virtually everyone in the industrialised nations has access to a phone. On average there are (in 2003) 58 phones (including cellular subscribers) per 1,000 people in the developing nations – in the LDCS the equivalent figure is only eight phones per 1,000 inhabitants (UNDP, *Human Development Report 2005*, p. 265).

Good ICT facilities are increasingly becoming a prerequisite for successful export businesses. A promising circumstance is that new technology, spearheaded by mobile Internet services, drastically reduces the costs of installing and upgrading telecommunication systems in low-income countries. However the "digital divide" remains huge. It is estimated that 0.4 percent of the population in LDCS are (in 2003) Internet users, as against over five percent in developing countries as a whole and close to fifty percent in high-income countries (UNDP, ibid.).

Internet services in low-income countries are appreciably more expensive than in rich countries. The services are also far inferior; broadband connectivity is rare and poor infrastructure often results in sub-standard speeds and low reliability (see further UNCTAD, *"The Digital Divide Report: ICT Diffusion Index 2005"*).

5.1.4 Domestic market size

As previously noted, the constraints presented by a small domestic market make it impossible for most LDCS to industrialise on a broad front. In order to have any prospects of success, they must attempt to exploit economies of scale within certain limited areas.

It is difficult for countries with a narrow economic base and limited experience of trade and international marketing to break into foreign niche markets. In addition to technological demands for efficient, large-scale production, manufacturers in LDCS often face competitive disadvantages associated with high shipping and transaction costs. Many LDCS used the WTO questionnaire mentioned above to vent their considerable frustration at what they see as the virtually prohibitively high costs of international freight and insurance.

5.1.5 Financing issues

Problems associated with the financing of foreign trade are legion in LDCs. Both export and import financing face major problems, particularly in the majority of LDCs that are seriously in debt and have a poor credit rating.

This is partly linked to the low level of savings in LDCs, which limits access to capital in general. In addition, the domestic financial sector is poorly developed as a rule and forms a bottleneck for investments and for companies' access to working capital in general. But even external financing is problematical.

Normal supplier and trade credits are more difficult to obtain for the majority of LDCs than for other, richer countries while interest rates and loan conditions are often less favourable. It is expensive to be poor, and to run a business in a poor country.

5.1.6 New customer demands

In addition to the demands placed on successful exporters that have been briefly addressed above – such as a sound economic policy, supportive institutions for trade and development, human resources and physical infrastructure – we can add the fact that today's exporters need to meet growing and increasingly detailed demands from their customers.

The changes in business practices in recent decades, such as reduced stock levels and just-in-time deliveries, mean that purchasing companies demand greater security of delivery and goods of an even and high quality. Many larger companies have now introduced quality management systems. Such systems, e.g. the international certification standard ISO 9000, are administratively complicated and costly to implement. Increasingly, these certification organisations in their turn have to gain official approval through accreditation; another expensive process.

In order to be able to compete in the industrial goods market especially, exporting countries are required to have the necessary administrative infrastructure including standardisation organisations, certification bodies, testing laboratories and so on. These institutions also need to be accepted internationally.

Consumers are also making tougher and more complicated demands. In order to be competitive, both goods and packaging must be designed in a way that attracts consumers just now. In the textiles and clothing industry in particular, designs must keep pace with current fashions.

Many customers are also beginning to demand that goods should satisfy ethical and environment demands, demands that are increasingly systematised in the form of criteria for different forms of certification and labelling. The environmental demands often apply to both the products themselves and how they are produced, for instance organic fruit should be both free of chemical pesticide residues and produced in an environmentally acceptable manner. Most environmental labels such as the Nordic Swan and the Swedish "Good Environmental Choice" are suitable for products that, generally speaking, are not exported from LDCs. Important exceptions are the sector specific labels for sustainable forestry (Forest Stewardship Council) and different certifications for organic agricultural products that can potentially be of major significance for LDC exports.

Ethical demands mainly concern the production process itself. Here too these demands are systematised in the form of labelling and certification using two different approaches, one of which is mainly concerned with agricultural production and the other one with industrial products.

The fair trade labels (such as Max Havelaar and Transfair) can be placed on coffee and tea, for instance. This label has its origins in so-called alternative trade with the focus on a fair share for the producer. In recent years, Codes of Conduct have been introduced by many transnational companies selling manufactured goods. These Codes of Conduct consist of a series of demands that suppliers must meet, such as ILO (International Labour Organisation) conventions on child labour, discrimination, and the right to association and collective bargaining.

The lack of international harmonisation and coordination between different systems makes it complicated and more expensive for producers to satisfy both ethical and environmental demands.

Most of the increased customer demands are purely commercial, but there are also statutory requirements in the importing countries that must be met. This primarily applies to health and safety requirements for products, plus in certain cases demands that packaging should be recyclable. While these new regulations have the objective of protecting consumers, in actual practice they tend to act as non-tariff barriers to trade for low-income countries with insufficient capacity to comply with the increasingly sophisticated demands.

The regulations set out in the WTO rules concerning sanitary, phytosanitary and other conditions are discussed in more detail in Chapter 8.

Introduction to external factors: LDCs' market access

CHAPTER 6

In this and the following chapters, external factors which affect LDC trade are examined. These factors consist of international regulations and the occurrence of trade barriers on LDC export markets. The framework of LDC market access is currently determined in WTO (Chapters 7–12 and Chapter 15), however individual tariffs on the largest export markets are unilaterally set by the importing country itself. On the markets of industrialised countries, different systems are normally applied concerning tariff reduction for developing countries i.e. so called preference systems (see Chapter 13). Chapters 9 and 10 discuss, in addition to WTO regulations, the industrialised countries' trade barriers in the agricultural products markets so vital to LDCs. Trade barriers between developing countries are covered in Chapter 14 which deals with South-South trade and regionalisation. Below, a summarised picture of LDCs' market access is presented.

6.1 Difficult to measure

Market access is difficult to measure in a fair and precise manner. Firstly, non-tariff barriers such as quotas and other regulations can affect export opportunities just as much as import tariffs. There are also a number of other constraints that countries, and in particular low-income countries, face in trying to expand their exports such as sanitary and phytosanitary standards, ethical or environmental rules, complex rule of origin which may serve to reduce LDCs preferential access to export markets, etc. These barriers to trade – which for the LDC group as a whole have become more important than tariffs – will be further discussed in subsequent chapters.

Secondly, tariffs are also difficult to describe in a standardised fashion as information on average tariffs mislead if charges vary considerably for different products. Extremely high tariffs on one or two types of goods can spell disaster if they apply to the very few products currently exported – or potentially exported in the future – by LDCs.

With these reservations in mind we will present a general picture of LDCs' market access.

6.2 Tariffs

As indicated earlier, average tariffs have been reduced substantially since the mid-90s. Between 1994 and 2005, average tariffs were reduced by 53 per cent in developed countries and 67 per cent in developing countries. Table 4.1, based on UNCTAD's *Trade and Development Report 2006* (p. 76), shows average tariff levels in developed and developing countries in 2005.

Table 6.1: Effectively applied tariffs in developed and developing countries, 2005, weighted averages, all products (per cent)

Markets	Exporting regions	
	OECD	Developing countries
OECD	1.29	2.12
Developing countries	5.85	4.88

It should be observed that all such calculations of tariffs based on weighted averages of actual trade grossly underestimate the degree of protection because of the existence of high or even prohibitive tariffs on many products, in particular agricultural products. These high tariffs have the effect of reducing or eliminating trade in such products, thereby concealing the true extent of tariff protection when estimates based on actual trade patterns are made.

If a different measure of tariff protection is used (Swedish National Board of Trade, 2006a, pp. 24 ff.), average tariffs, i.e. simple arithmetic averages, in the OECD countries before the Doha Round are estimated at between four and five per cent for manufactured goods and between 15 and 20 per cent for agricultural goods. A similar calculation resulted in average applied tariffs of around 18 per cent for LDCs and 14 per cent for developing countries in general.

By and large, the OECD countries apply higher tariffs to exports from developing countries than to those from other developed countries. In this sense, there is a bias against developing country exports. The reason is that average tariffs are highest on products of special significance for developing countries, in particular labour-intensive manufactured goods such as textiles and clothing, where average OECD tariffs on products originating from developing countries are 12.12 per cent (UNCTAD 2006, based on weighted averages). The countries most affected are Asian countries without preferential trade agreements and with a high share of labour-intensive industrial goods.

Developing country exports to other developing countries are confronted with higher average tariffs than on OECD markets where, on the other hand, non-tariff barriers, not least against agricultural products, are higher.

Although tariffs are gradually losing their importance as barriers to trade, to achieve duty-free and quota-free market access on developed country markets for LDC exports has long been an aspiration of the international community. Before the collapse of the Doha Round in July 2006, prospects appeared good for major advances in this respect. Indeed, the declaration from the 6th WTO Ministerial Meeting in Hong Kong in late 2005 contained a pledge from developed WTO members to provide duty-free and quota-free market access for at least 97 per cent of products from LDCs by 2008.

The great majority of developing countries, including all LDCs, currently enjoy trade preferences in the form of low or even zero tariffs on most of their exports to OECD countries (but seldom to other developing countries, unless they are members of the same trade bloc). The GSP, Generalised System of Preferences, (see Chapter 13) provides preferential entry for a wide range of products from 144 countries and territories into OECD markets. In addition, the EU has its own preference system for the ACP (African, Caribbean and Pacific) group of countries, and African countries have preferential access to the US market under the Africa Growth and Opportunity Act (AGOA).

In 2003, an estimated 27 per cent of LDC exports remained dutiable. OECD countries – in particular the United States and Japan – accounted for 61 per cent of this total and developing countries for the remaining 39 per cent (WTO, *World Trade Report 2006*, p. xxi). The LDCs most affected are a handful of Asian LDCs, including Bangladesh, whose trade preferences are inferior to those enjoyed by African LDCs.

Market access conditions for LDC exports to developing country markets are determined by the profile of MFN (Most Favoured Nation) tariffs since only a few developing countries, such as China, provide non-reciprocal market access (WTO 2006, *ibid*). Several middle-income countries have, however, made commitments indicating a willingness to abolish tariffs for LDC exports.

LDC market access in Europe has been greatly improved thanks to the EU decision on duty-free import from LDCS according to the EU's so-called EBA regulation 416/2001 ("Everything but Arms"[17]). According to this decision, all tariffs and quotas should be abolished on all products from 5th March 2001, with the exception of bananas for which trade barriers should be gradually decreased until 2006, and sugar and rice where the gradual decrease will continue until 2009. In order to compensate for the delay on these products, tariff-free quotas have been opened and increased a little every year. At the same time the European Commission will monitor the import of these three products and "… apply safeguards if necessary to prevent damaging surges" (European Commission 2001).

The EU decision is promising in that it will bring benefits to the world's poorest countries. It also represents an important political gesture showing the commitment of the EU to promoting a more equitable distribution of the benefits of international trade. One major limitation of the proposal is that it is non-contractual compared with, for example, the Cotonou Convention, and therefore can be changed unilaterally by the EU. The initiative is also subject to a new, special safeguard clause that allows the European Commission to withdraw these preferences if they were to result in "massive increases in imports".

Another important drawback is the problem of rules of origin which are applied and which determine whether or not goods are eligible for the EBA preferences. The EBA rules of origin are actually appreciably more restrictive – and complicated – than those that are applied in other preference agreements such as the Cotonou Agreement (see Chapter 13), and many LDCS therefore prefer to use these other schemes rather than EBA.[18]

To date, it is difficult to discern any positive impact of EBA on LDC exports to the European Union.

As indicated above, at the WTO Ministerial Meeting in Hong Kong in 2005 other OECD countries, including the United States, made vague promises to introduce tariff and duty-free access to virtually all LDC exports. Similar commitments were made by a number of middle-income developing countries. It is still very unclear what these promises may be worth however the US, in particular, reserved the right to make a number of exceptions for "special products" of a particularly sensitive nature, and

17 Regulation 416/2001 is often called "Everything but arms" in the media and by the EU. Actually this is quite misleading as LDCS do not manufacture any weapons for sale abroad, and even if they did they would be forced to import many of the components which in turn would make it impossible for them to fulfil current country of origin regulations for tariff-free market access to the EU.

18 For an interesting discussion, see Swedish Board of Trade (2006b).

made the commitment conditional on various concessions regarding market access.

The breakdown, or suspension, of the Doha Round in July 2006 also signifies that nothing substantial is likely to happen in this area as long as the current impasse in WTO negotiations lasts.

We will return to the various preferential modalities that have developed over time. Suffice it here to stress that improvements have been made in recent years as regards duty-free and quota-free access to the EU and US markets for the LDCs, implying that tariffs have become increasingly unimportant. It should however also be observed that the overall reduction of tariffs has led to what is called "preference erosion", meaning that various bilateral and multilateral preference schemes designed to improve market access for low-income countries have become less and less valuable to the beneficiary countries as import duties are reduced for all, whether they be LDCs or not.

6.2.1 Tariff peaks and tariff escalation

While successive rounds of trade liberalisation have been successful in reducing average tariffs to rather low levels, the tariff barriers that have been most problematic for developing countries have been the widespread use of so-called *tariffs peaks* and *tariff escalation*.

These higher rates apply primarily to products which other countries label "sensitive". Generally speaking, tariffs are much higher on agricultural products than on industrial goods. The so-called tariff peaks, i.e. extra high charges for certain individual products (according to UNCTAD's definition, tariffs in excess of twelve per cent), are often several hundred percent. In the case of LDCs it should also be pointed out that tropical agricultural products in unprocessed form which do not directly compete with industrialised country growers or foodstuffs companies, are met by low or zero tariffs.

Perhaps the most serious tariff problem for developing countries is the so-called *tariff escalation*, i.e. the fact that that tariff rates tend to rise with the degree of processing. The combination of low or non-existent tariffs on raw materials and higher tariffs on processed products, not least processed agricultural products, creates tariff escalation which acts as a barrier to processing and therefore the industrialisation of the exporting countries. For example, when the USA's and EU's import tariffs are much higher on roasted coffee and chocolate as compared to coffee and cacao beans, the tariff on the actual processing is consequently much higher.

Table 6.2 provides an illustration of tariff escalation on a few commodities of interest to LDCs.

Table 6.2: Tariff escalation on coffee, sugar and cocoa markets: average tariff in the EU, US and Japan

Average tariff on	Coffee	Sugar	Cocoa
Raw commodity	4.5%	15.6%	0.2%
Processed products	13.6%	28.3%	23.5%

Source: Based on Sexton et al. (2003), quoted by Ashafa (2005), p. 22.

In spite of the otherwise generous tariff treatment by the rest of the world, developing countries tend to be negatively affected by trade barriers in just the areas where their export potential is highest. Tariff structures may therefore contribute to trapping these countries into continued raw material exports and inhibit industrialisation in the areas which show the most promise.

It should be observed, finally, that on 18 December 2005 the Hong Kong WTO Ministerial Meeting in its unanimously adopted Ministerial Declaration gave a strong commitment to work for "*…the reduction or elimination of tariff peaks, high tariffs and tariff escalation, in particular on products of export interests to developing countries*". As with so many other declarations implementation is, however, lagging.

WTO – the global trade regulatory framework

CHAPTER 7

Global rules for international trade are negotiated at, and monitored by, the World Trade Organisation, WTO. WTO agreements regulate the actions of countries, while companies are regulated by national legislation. After the admission of Vietnam in January 2007, WTO has currently 150 members.

Russia is the only major trading nation which is not yet a member. 32 of the LDCS are members, while 10 have observer or applicant status.

A large part of the remainder of this study deals with WTO. The present chapter should be regarded as an introduction, presenting WTO's regulatory framework in general terms, including its dispute settlement procedures and approach to developing countries.

Recent developments which led to the suspension of the Doha Round in July 2006 will be discussed in Chapter 15.

7.1 From GATT to WTO: more tasks and a broader mandate

WTO was formed in 1995 in connection with the completion of the Uruguay Round of negotiations. This Round was the latest in a series of major negotiation sessions and led to the expansion of the organisation's body of regulations in several areas. WTO was preceded by GATT *(General Agreement on Tariffs and Trade)*, the general tariff and trade agreement which was signed in 1947. The GATT agreement, which will be discussed in the following chapter, contains the basic principles which permeate the body of regulations and still form its core. However, it has been complemented over the years by a number of additional agreements, covering entirely new areas and sectors (see chapters 9–12).

From its original purpose of controlling tariffs and import quotas, the current regulatory framework deals with a wide variety of other national regulations which may affect international trade such as product standards, export subsidies, health & safety requirements etc.

With the establishment of the WTO, the international trading system was given a fundamentally new role. From the negative regulation of the GATT – i.e. rules dictating what governments must *not* do – to a positive regulation establishing what governments *must* do.

In contrast to most other international agreements, WTO regulations are binding in that countries which are found to have violated them must compensate the countries negatively affected or be "punished" in the form of trade sanctions. It is not, however, the organisation WTO who punishes anyone, it is the country that has won the dispute who is permitted to introduce trade barriers against the erring party. Consequently if a small country wins a dispute against a larger one, in practice it has almost no chance of introducing trade sanctions by itself which are severe enough to affect the larger country. At the same time experience has shown that respect for the system is so strong that most countries follow the ruling of the panel without the introduction of any punitive sanctions. LDCs benefit from this respect for the system, but in practice gain no benefit from the actual dispute settlement mechanism.

The fact that WTO establishes general regulations which must be followed by all members is basically positive for smaller countries which may otherwise be easy victims of the arbitrary behaviour and far superior economic power of the larger countries.

7.1.1 The members decide

The top level decision-making body of the WTO is the Ministerial Conference, which is supposed to meet at least every two years. The latest conferences have taken place in Seattle (1999), Doha (2001), Cancún (2003) and Hong Kong (2005). Under the Ministerial Conferences, the General Council, where all member states participate, meets regularly at the WTO headquarters in Geneva. At the next level, various councils, specialised committees and working groups deal with the individual agreements and with special issues such as membership applications.

WTO is a member-driven organisation, consequently the Secretariat in Geneva is comparatively small and initiatives for new regulations always originate from member countries. This makes the WTO very different to such international institutions as the World Bank or the IMF, which have a much higher degree of institutional autonomy and strength.

Another major difference is that in principle, WTO decisions are made by consensus. However, each country's influence is obviously dependent on its importance as a trading nation and its capacity to be an active participant in WTO negotiations in Geneva. In practice it is difficult or impossible for a small, individual country to put in its veto (so far, this has never happened). If the major trading parties agree on a proposal then it will be normally accepted by all members.

While WTO in its earliest stage was heavily dominated by the OECD countries, the last few years have witnessed how the bargaining power of developing countries has increased substantially. Even if it has rarely been possible for them to drive their own issues forward, they have at least been able to block progress in areas prioritised by industrialised countries. This primarily applies, however, to the more advanced developing countries. LDCs are still, generally speaking, marginalised as far as WTO processes are concerned.

In the WTO, member countries self-select whether they want to be classified as "developing" or not. This is not the case for the LDCs, for which the categorisation must follow the UN criteria (see Chapter 1).

As will be further discussed in Chapter 15, the WTO Ministerial Meeting in Cancún, Mexico in September 2003 demonstrated the new assertiveness of the developing countries. The alliance formed between the middle-income countries and the LDCs in Cancún, demanding a thorough reform of OECD countries' agricultural policies before negotiations on certain issues pushed by the rich countries could be put on the agenda, was strong enough to cause the meeting to collapse without any decisions whatsoever. Contrary to most expectations, this alliance between middle and low-income countries has remained quite strong even after Cancún.

7.1.2 The negotiation process

In order to understand the dynamics of trade negotiations it is important to be aware of their basically contradictory nature. Liberalised trade is the final objective of WTO, based on the conviction that freer world trade creates the preconditions for growth and increased welfare in all participating countries. This is the underlying philosophy, and most governments recognise the thought, in principle, that it is good for each country to open its markets to imports.

In practice, however, WTO members are not expected to voluntarily liberalise their imports, they rather do so only as a result of concessions and in exchange for the reduction of trade barriers by their trading partners. A simplified description could be that national interests are still formulated based on a considerable degree of mercantilism: everyone wants to export, i.e. enter other countries' markets in the sectors where their own companies can compete. And at the same time every country wants to protect its own market in the business areas where the domestic companies risk being forced out by international competition. It is therefore hardly surprising that liberalisation has progressed much quicker in areas of interest to industrialised countries, such as industrial goods and financial services, while trade is still strongly regulated in the areas which are, or could be, important to the exports of many developing countries i.e. primarily agricultural products.

It should also be emphasised that the outcome of the negotiations basically reflects the bargaining power of the negotiating parties rather than being based on the development needs of low-income countries. The following analysis by Dani Rodrik may be kept in mind when we try to understand the rationale behind certain WTO agreements (many of which have, in fact, very little to do with both trade and development):

> *"The rules for admission into the world economy not only reflect little awareness of development priorities, they are often completely unrelated to sensible economic principles. WTO rules on anti-dumping, subsidies and countervailing measures, agriculture, textiles, trade related investment measures (TRIMS) and trade related intellectual property rights (TRIPS) are utterly devoid of any economic rationale behind the mercantilist interests of a narrow set of powerful groups in the advanced industrial countries."*
> (Rodrik 2001, p. 27).

7.2 New sectors and agreements during the Uruguay Round

The previous GATT possessed a limited mandate: trade in industrial goods (except textiles and clothing). During the Uruguay Round, new sectors were added such as agriculture, services and intellectual property, which explains why many WTO issues are considerably more difficult, and more politically controversial, than previous GATT agreements. A new regime was constructed which affects developing countries to a much greater degree and which is much more mandatory in nature than was previously the case.

A series of new agreements were added. With the *Agreement on Textiles and Clothing* it was decided that the import quotas which had negatively affected developing countries for a long period of time within the framework of the Multi-fibre Agreement would be decreased and finally abandoned over a period of ten years (see Chapter 9). The *Agreement on Agriculture* brought trade in agricultural products under general rules for the first time (see Chapter 10). These agreements are generally stated to be most important to developing countries and the major carrot used to persuade them to join WTO. Developing countries hoped that these agreements would lead to industrialised countries opening their borders to the exports of developing countries in these important areas. However, liberalisation on this scale has not yet occurred in agriculture.

The Uruguay Round also caused regulations in many existing agreements to be further specified, and it also reinforced the dispute settlement mechanism. In addition the *Trade Policy Review Mechanism* (TPRM) was accepted. This mechanism regulates WTO's regular examinations of member country trade policies. LDCs are examined less regularly than other countries.

The results of the Uruguay Round are usually referred to as a "single undertaking", which means that all member countries must either sign all the agreements – or be kept totally outside them. This was especially important to developing countries. In previous rounds they had regularly used the opportunity to sign the agreements they considered of interest only ("à la carte"). Now they were forced to adopt, in a very short period of time, several extremely complicated and far-reaching agreements without actually being able to judge if it was in their interest to do so. In addition, the purely administrative costs of implementing some of these agreements have proved to be extremely high. A rough estimate from the World Bank in the late 1990s showed that the costs for a developing country to implement three[19] of the agreements which require structural changes to national legislation are around USD 130 million, i.e. as much or more than many LDCs' annual development budgets (Finger and Schuler 1999).

In Chapters 9–12, a review of the main WTO agreements is presented, with special emphasis on their implications for the least developed countries, which still enjoy a number of preferential concessions from the "single undertaking".

7.3 Dispute settlement

When WTO was formed, its dispute settlement powers became binding which has led to an increased number of disputes and increased respect for the process.

There are now carefully stated regulations as to what the process should include. Firstly the parties hold consultations, then a panel of experts is appointed to review each individual case. The Panel submits a report which is then, more or less automatically, adopted by the dispute settlement body (which consists of all members). Then it is possible to appeal to the so-called *Appellate Body*, which consists of three, permanently employed lawyers whose verdict sets a strong precedent.

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[19] The Agreement on Customs Valuation, the SPS Agreement and the TRIPS Agreement.

One weakness connected to the WTO dispute settlement mechanism, as for a large part of international law in general, is the lack of efficient enforcement mechanisms. While there is a court to impose punishments within WTO, there is no sheriff; it is up to the country who has won the dispute to punish the guilty party.

Dispute settlement thus entitles the country which has won the dispute to impose, after authorisation by the Dispute Settlement Body, retaliatory measures in the form of, for example, punitive tariffs. These punitive tariffs may apply to a totally different category of goods than that involved in the original dispute (so called *cross-compliance*). Consequently USA imposed a 100 per cent punitive tariff on a large number of EU goods – such as Swedish ginger biscuits – when the EU a few years ago refused to follow the WTO verdict concerning the EU's banana policies and ban on importation of meat treated with hormones.

The larger the country, the easier it is to impose hard-hitting sanctions. If, for example, Burkina Faso were to win a dispute against the United States it is not very likely that the threat of punitive tariffs on American goods imported into Burkina Faso would be enough to persuade the US Congress to change the US policy and follow WTO's ruling.

The losing party in a dispute can also offer the winner compensation, primarily in the form of trade concessions on its own market. However, supply constraints in the LDCs mean that they would normally not be able to use a compensatory market access offered by the losing party.

The difficulty in taking advantage of this alternative is that the parties must agree on the compensation and that the actors/companies negatively affected by the trade barriers that have been found to break WTO regulations are seldom the same parties who profit from the trade concessions offered as compensation.

The new dispute settlement system within WTO has been utilised to a relatively extensive degree by both industrialised and developing countries.

Table 7.1 below shows how disputes during the first ten years (1995–2005) are distributed between industrialised and developing countries. To date, no LDC has been involved in a dispute leading to the Panel as either plaintiff or defendant. On many occasions LDCs have, however, taken part as third parties, supporting another country who has presented a case concerning, for example, the US cotton subsidies or the EU sugar policies.

Table 7.1: Disputes reported to WTO 1995–2005

Complainant	Defendant	Number of cases	
		1995–1999	*2000–2005*
Industrialised country	Industrialised country	66	49
Industrialised country	Developing country	42	20
Developing country	Industrialised country	21	36
Developing country	Developing country	15	43
Industrialised+developing	Industrialised country	4	2

Source: 1995–99: Seth (2000, p. 41), 2000–2005: WTO, web, June 2006.

By July 2005, only about 130 of a total of 332 cases had reached the full panel process. (source: WTO's home page www.wto.org). Most of the rest have either been notified as "settled out of court", i.e. been settled via bilateral negotiations without a panel being appointed, or remain in a prolonged consultation phase – some of them since 1995.

Of course, it is also very common for states to infringe against many WTO regulations and agreements without other states finding out about it, or taking the trouble to report a dispute.

The model applied to dispute settlement at WTO means that the countries must handle their cases themselves. This is both complicated and expensive, and in order to assist the poorest countries to assert their rights an ODA-financed legal advisory centre has been established in Geneva with the task of supporting developing countries with legal advice.

One idea which might be worth trying is to establish an "ombuds office" for LDCs with the powers to take up and handle cases and not merely act as adviser to LDCs. A suitable institution to act as host to such a "LDC ombuds office" might be UNCTAD.

7.4 Special and differential treatment of developing countries

Since as early as the 1950s, developing countries have received special benefits known as *special and differential treatment* (S&D or SDT). SDT does not form a special programme aimed at strengthening developing country trade and development, it is rather a collection of disparate provisions of extremely varied character and importance. Many of them apply to all developing countries, others only to LDCs. These provisions can, in summarised version, be divided into those that:

- aim at providing developing countries with preferential market access;
- encourage industrialised countries to consider the needs and interests of developing countries when they apply agreements, for example to consider the interests of developing countries when national standards are adopted or to desist from reporting disputes with LDCS (generally not binding regulations);
- provide developing countries with more leeway in the design of their national regulations. For example, LDCS are allowed to introduce certain export-related subsidies which are forbidden in other countries;
- promise technical and financial support to developing countries (not binding);
- grant developing countries permission to take safeguard measures e.g. to introduce import restrictions when experiencing balance of payment problems;
- grant developing countries extra long implementation periods in new agreements. LDCS are often granted longer deadlines than other developing countries.

7.4.1 Historical development of special and differential treatment

In the mid-1950s, developing countries were granted special permits to introduce import restrictions when experiencing balance of payments problems. In 1965, an entirely new section was included in the GATT Agreement, "Trade and Development" (Part 4). This part, which is not binding, consists of three articles:

Article 36 establishes the principle of non-reciprocity, i.e. that industrialised countries must grant concessions to developing countries without expecting anything in return;

Article 37 encourages industrialised countries to open their markets more to developing countries;

Article 38 states objectives and principles for the granting of unilateral tariff concessions to developing countries. Some years later this materialised in the form of the GSP System (General System of Preferences, see Chapter 13).

At the Tokyo Round (1973–79) a number of "codes" were adopted which expanded GATT's body of regulations to include technical trade barriers and subsidies. In spite of the fact that these codes contained several special regulations for developing countries (less severe requirements or that developing countries were totally exempted from certain requirements plus promises of technical assistance) many developing countries declined to accede to these regulations. At the same time the so-called *Enabling Clause* was adopted which regulates opportunities to provide developing countries with special tariff concessions through, for example, the Generalised System of Preferences (GSP).[20] At the same point in time, LDCs were identified as a special group which deserved special treatment.

During the Uruguay Round, the previous possibility for developing countries to decline to observe certain regulations was removed as negotiations were implemented as a "single undertaking" where countries had to accept or reject negotiation results as a package. Consequently, developing countries made much greater individual commitments than previously. This Round therefore took a step back from the principle of non-reciprocity. SDT mostly consisted of extended deadlines, promises of technical assistance, measures to promote transfer of technology and, in certain cases, less severe requirements as concerns liberalisation. The agreements contain many references to LDCs, however few of them are binding with the exception of extended deadlines as compared to other countries. Taken as a whole, it can be said that the strength of the SDT for developing countries was diluted by the Uruguay Round (Youssef 1999).

7.4.2 Special and differential treatment in practice

Certain SDT provisions have been utilised relatively often. This applies, for example (with Bangladesh as the only LDC) to the opportunity to maintain import restrictions with reference to balance of payments problems. At the same time, developing countries have been exposed to heavy pressure not to make use of this possibility. Developing countries regularly utilise their entitlement to extended deadlines. However, the ODA and technical assistance promised has generally been slow to materialise.

All industrialised countries apply some form of preference system versus developing countries. For developing countries generally, GSP benefits have been diluted in pace with the decrease of general tariff levels; the so-called preference erosion mentioned earlier.

7.4.3 Is special and differential treatment relevant?

When assessing SDT provisions it is important to remember that they have not been introduced because of a common conviction that this is the best way to promote the development of developing countries. They have actually been granted to developing countries after negotiations in which they have been forced to make concessions in return.

20 GSP implies a deviation from the principle that all tariff reductions should apply to all GATT/WTO members (Most Favoured Nation Principle).

SDT is generally superficial in the sense that it is not based on analyses of the special needs of developing countries. The extremely approximate criteria on which the regulations are based (that a country is a developing country, LDC or has a GDP of less than USD 1,000 per capita) do not contribute to making these exemptions very meaningful either. LDC specific preferences can also disturb relationships between neighbouring countries who live under largely the same economic and social conditions, but have landed on different sides of the LDC borderline.

The extended deadlines enjoyed by developing countries are also often rather arbitrarily established. The rationale behind longer deadlines is based on the assumption that the regulations are, in principle, good for everyone but that developing countries need a little more time to implement them. Consequently exemptions are intended to deal with temporary, transitional problems in the introduction of new regulations, not to manage development problems.

It should not, therefore, be surprising that SDT has had such a limited effect. The original WTO body of regulations is, in itself, a grand mixture of sound economic principles on the one hand and regulations which are clearly the result of a power struggle between strong countries acting in their own interests on the other. This is why it is not easy to identify a simple formula to adapt the regulations to suit developing countries.

7.4.4 Special and differential treatment in the future

An intensive debate is currently underway both inside and outside the WTO on how SDT should be designed in the future. New approaches are often called for. Many proposals are based on making SDT less general and more differentiated on the basis of the actual situation in the various countries. A few years ago Sweden proposed that SDT be transformed into a development instrument. This would mean that instead of granting general deadline extensions, the parts of the agreements which individual developing countries should and were able to implement at the same time as industrialised countries would be identified. A schedule for the other parts would then be established and finally the forms of technical assistance necessary for their implementation.

In a World Bank study (Finger and Schuler 1999) on developing country implementation of three WTO agreements (Customs Valuation, TRIPS and the SPS agreements) it was stated that the agreements were not sufficiently adapted to the conditions and needs experienced by developing countries. The agreements are based on a faulty or incomplete diagnosis of the policy changes necessary in developing countries, and the measures they demand that the countries implement are erroneous or completely insufficient from a development perspective. Selecting a small, often irrelevant detail concerning necessary reforms, as is done in WTO agreements, is almost never meaningful. For example, demands have been made that WTO members introduce new principles of customs valuation. This is actually an extremely small part of more comprehensive reforms of the entire customs management system which are necessary in the majority of developing countries – it does not matter how much customs valuations are changed if the containers sit on the dock at the customs station for weeks. The report also questions whether the principles of customs valuation described in the agreement are actually the most suitable for all developing countries, given their other institutional constraints.

If the conclusion is drawn that all WTO agreements are not suitable for developing countries, extended deadlines become meaningless as an instrument of SDT. Extended deadlines will be necessary, but based on real needs and connected to other, broader policy changes which must also be implemented in these countries.

It has been proposed (Meléndiz-Ortiz and Dehlavi 2000) that SDT should be designed using sustainable development as a point of departure. Current regulations are, for example, blind to the political and market failures which make it more profitable for many developing countries to exploit natural resources – and transfer the costs to society and future generations – than to invest in other activities. The proposal suggests that by using sustainable development as an objective, and applying an understanding of development processes in developing countries, more purpose-designed regulations can be established. If this is to be possible, more specific criteria for SDT must be established, not only macroeconomic indicators but also those which reflect each country's development situation at a deeper level. During the Doha Round, the Africa Group suggested principles which would make SDT "meaningful and relevant to the development needs", and that non-mandatory provisions be made mandatory (see Kleen & Page, 2006, pp. 37 ff.).

A key issue has been the demands from a number of developing countries to maintain what has been labelled "policy space", i.e. the possibility to use various policy instruments such as special import tariffs (mainly on food imports), export subsidies, preferential treatment of domestic producers and other measures which have been common in both developed countries and in successful newly industrialised countries in Asia. It should however be clear that the granting of a too generous policy space would go against several of the underlying GATT/WTO principles.

During the Doha Round, SDT negotiations have made little progress, while arousing considerable antagonism between different groups of countries. The special preferences enjoyed by LDCs – within WTO's SDT regulations or as a result of bilateral initiatives such as the EU's EBA – have also caused friction between LDCs and other developing countries. As observed by Kleen and Page (ibid, p. 90): *"As long as the SDT offered to LDCs was little different from that for other developing countries, as long as all SDT was regarded as an unimportant issue by most developed countries, and as long as GATT regulated only lightly what types of SDT were actually offered by developed countries, the issue of which countries were in which classes was more for academic debate than active negotiation. All these conditions have changed. For non-LDCs at low income levels, often with close regional association to LDCs (Kenya in East Africa, Zimbabwe or Mauritius in Southern Africa, Ghana or Nigeria in West Africa), what was a minor technical difference is becoming a conspicuous disadvantage, a potential cause of diverted investment, and at a minimum a complication from rules of origin in their own regions and in exports to other markets."*

There are, in short, many key issues related to SDT that need to be resolved, and many different concerns that need to be considered. The basic issue for future negotiations is if the, in practice, increasingly diluted principle of non-reciprocity, i.e. that lower commitments are made by developing countries than others, is worth preserving. Is the current move towards increased mutuality of undertakings really desirable? In our opinion, the principle of unilateral undertakings for OECD countries and real advantages for developing countries, especially LDCs, are well worth protecting.

The GATT Agreement and other agreements on trade in commodities

CHAPTER 8

WTO agreements are divided into three main categories: agreements which cover trade in commodities, trade in services and trade-related intellectual property (IP) rights. The original GATT Agreement belongs to the first category as do a series of other agreements, most of which will be dealt with in this chapter. The agreements on textiles and agricultural products are covered separately in Chapters 9 and 10, where a description of the importance of these commodities to the development of LDCs is also provided.

The agreements on trade in services (General Agreement on Trade in Services, GATS) and IP (Trade-related Intellectual Property Rights, TRIPS) are covered in Chapters 11 and 12. New issues relevant to a new round of negotiations within WTO – in particular the so-called "Singapore issues", which the OECD countries without major success so far have attempted move up the WTO agenda – are dealt with in Chapter 15, while the industrialised countries' preference system and South-South trade are discussed in Chapters 13 and 14.

Before presenting an overview of the pillars of the GATT agreements, it should be emphasised that GATT, during its early years when the organisation was dominated by the large OECD countries, paid very little attention to the special needs of the developing countries. The basic principle was originally that all rights and obligations should apply uniformly to all contracting parties, and it was only in the late 1950s and early 1960s that the organisation acknowledged the rights of less-developed countries to enjoy certain privileges. A milestone for the poorest countries was the Declaration on the Promotion of Trade of Less-developed Countries, adopted in 1961.

During the 1960s, further progress was made by GATT in recognising the special needs and conditions of developing countries (for a background see, for example, Catherine Grant, 2006). During the Tokyo Round, which preceded the Uruguay Round, a number of new decisions were taken with the aim of securing additional benefits for developing countries, and provisions were also made for a more favourable treatment of LDCs, including preferential market access and special and differential treatment discussed in the previous chapter. The Uruguay Round (1986–94) witnessed a further integration of the developing countries into the multilateral trading system, a tendency which has become even more accentuated during the Doha Round, launched in 2001 and somewhat euphemistically labelled the "Doha development round".

8.1 GATT and basic principles

GATT, the General Agreement on Tariffs and Trade, contains basic principles and regulations for tariffs and quantitative trade barriers, plus states the forms for tariff reductions concerning industrial goods.

The *Most Favoured Nation* (MFN) principle forbids any member from discriminating between two other countries. In practice this means that if a country lowers its tariffs as regards country A, the same tariff reductions must also apply to all the other GATT/WTO members. The principle does not only apply to tariffs, but also states that "like products" from all countries must be treated equally as concerns, for example, domestic taxes and charges, distribution regulations etc. Exceptions from the MFN have been made for customs unions and free trade areas such as the EU and Nafta, for special tariff reduction systems for developing countries (GSP, etc) and, of course, for cases when sanctions are imposed as a result of disputes.

The principle of *National Treatment* (NT) states that imported products must not be treated less favourably than domestically produced goods as concerns domestic taxes, distribution regulations etc. This principle is implemented in a less consistent fashion than MFN, as exceptions are made for import tariffs and also for other situations such as public procurement and subsidies for domestic production.

Within this GATT framework, tariffs have successively been reduced during the entire post-war period. Theoretically the process is that countries "bind" their tariffs, i.e. promise not to set various tariffs above certain levels. The tariffs that are then actually applied are often considerably lower than the levels that have been "bound".

8.2 Tariff reductions in the Uruguay Round: LDC countries gained least

As has been mentioned earlier, information on tariff reductions should be interpreted carefully as the average can be extremely misleading. There are also many different methods of calculating tariff reductions. Some figures which are often mentioned in connection with the Uruguay Round are that industrialised countries' industrial products tariffs were decreased by one third to 3.9 per cent. Under GATT, industrial tariffs were decreased in several steps from an average of 47 percent in 1947 to only six in 1980.

Watkins (1997) has pointed out that tariffs in trade between industrialised countries were decreased more (45 per cent) than the total average of industrialised countries' tariff reductions. For import from Asia, tariffs were decreased by an average of one third, while tariffs on imports from the developing country group as a whole were reduced by only 20–25 per cent. LDC countries gained least from the point of view of market access. When the Uruguay Round had been fully implemented, the average tariff level on imports from LDC countries to industrialised countries was 30 per cent higher than the global tariff average. For developing countries as a whole, tariff levels are 10 per cent higher.

As observed in Chapter 6, the reason for this apparent discrimination was not that the industrialised countries wanted to punish developing countries – only that the composition of exports from poorer countries was dominated by agricultural products and textiles, sectors excluded from the GATT negotiations and where protectionist policies were most pronounced.

Before the Uruguay Round, developing countries made minor commitments and concessions, but could draw advantage from MFN tariff reductions which applied to all members since, for example, EU and USA had agreed to reduce their tariffs. This type of advantage has, however, decreased in pace with the increased development of special free trades agreements and tariff unions.

During the Uruguay Round, developing countries as a group made, in practice, greater tariff reductions than industrialised countries (Finger and Schuknecht 1999), even if their average tariffs are still appreciably higher than those of industrialised countries. At the same time developing countries were, as mentioned earlier, met by higher tariffs than industrialised countries as they export products for which tariff levels are higher.

LDCs also made certain, if more modest, commitments. They bound large numbers of their tariffs at a high level, however (Oyejide 2000).

8.3 Anti-dumping, safeguards and countervailing measures: different forms of protection against "free trade"

WTO's regulations entitle member countries to protect, in certain situations, their industry against dumping and import surges and to impose countervailing measures to counteract other countries' subsidies. These possibilities are included in the GATT agreement, but were specified and limited through the Uruguay Round in separate agreements: Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (anti-dumping), Agreement on Safeguards, and Agreement on Subsidies and Countervailing Measures.

8.3.1 Anti-dumping

According to the WTO regulations, dumping is defined as when a company exports a product at "less than its normal value", usually interpreted as cheaper than on the domestic market. The concept reflects the mercantilistic approach which characterises trade policy negotiations: the fact that the price of a product is low should actually benefit the importing country's consumers; however, in trade policy it is producer rather than consumer interests that are more often to the fore.

Purely destructive cases of dumping are extremely rare in the current business world. The clearly most common examples are the different forms of subsidies applied to exports of food surpluses practised by the rich countries (see further Chapter 10). Poor countries can seldom afford to give state subsidies to finance dumping.

If a country can prove that it has been negatively affected by dumping, it is entitled to impose a type of punitive tariff, so called anti-dumping duties, against the company actually doing the dumping. In order to be allowed to impose anti-dumping duties, the country which feels it has been offended against must show that dumping exists, that there is material injury or threat of material injury to its domestic industry and that there is a causal connection between the two.

The role of the Dispute Settlement Panel (see also Section 7.3) in anti-dumping disputes is severely constrained. They merely examine if the countries which apply anti-dumping measures have made the necessary investigation in the correct manner, not if they actually have been following the rules.

Since the mid-1980s, anti-dumping has been the most common method for certain industrialised countries (Australia, USA, Canada, New Zealand and EU) to protect their own industries. Anti-dumping tariffs are often extremely high, 30–50 per cent. Something which is formally a method of protecting companies and markets against unfair business practices has actually become a tool for protectionist measures to help domestic companies.

Since the early 1990s, several developing countries have also begun to impose anti-dumping duties, so that there are currently a total of around 30 countries exploiting this opportunity. Between 1995 and 2005, a total of 3,000 anti-dumping investigations were carried out. Companies manufacturing metals, chemicals, machinery, electrical equipment, plastics and textiles are most commonly affected. The most common targets of anti-dumping are China, South Korea, Taiwan and the United States (source: *WTO, AD initiations*, www.wto.org).

Anti-dumping measures are also being taken against low-income countries; the application of anti-dumping tariffs on Vietnamese exports of shrimp and catfish to the United States and on Vietnamese footwear exports to the EU in 2006 are recent, and much publicised, examples.

Industrialised countries generally aim their anti-dumping tariffs against other industrialised countries and countries in transition, while developing countries aim theirs against South, North and East in equal amounts. In proportion to the amount of exports, developing countries are affected more than industrialised countries. It can therefore be said that developing countries are currently both greater users and targets of anti-dumping than industrialised countries.

There is a major risk that accusations of dumping will become increasingly common and that more and more countries will begin to use this method for purely protectionist reasons. The large-scale losers in this sort of trade war would most likely be developing countries – in addition, of course, to the consumers in the countries who level the dumping accusations.

There are very good reasons to question the actual concept of dumping as it has come to be applied in trade disputes. If trade-distorting subsidies are already forbidden according to WTO regulations (with the exception, so far, of industrialised countries' agricultural exports), and countries have access to so called safeguards (see below), no special anti-dumping regulations should be needed.[21]

To date, LDCs have neither been affected by, nor used, anti-dumping measures.

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21 The cases which are sometimes discussed in economic literature as examples of destructive dumping are those which go under the name of "predatory pricing", i.e. a situation in which a large company with superior financial resources reduces its prices during a short period of time in order to wipe out its competitors and then raises prices again when competition has been eliminated. Cases of pure "predatory pricing" are, however, rare within international trade.

8.3.2 Safeguards

If a country can prove that increased import of a certain product "causes or threatens to cause serious injury to domestic industry" it is entitled to impose temporary safeguards in the form of, for example, extra tariffs or quota reductions. It is often a very rapid import increase which triggers this type of measure.

Industrialised countries may retain such safeguards for a period of eight years, developing countries for a maximum of ten. In addition, developing countries may re-impose these safeguards more rapidly than others.

Safeguards affect all countries which export to the country in question, which makes them considerably less aggressive than anti-dumping duties (anti-dumping action is aimed at individual exporters). Developing countries are, however, exempted from safeguards if their share of exports to the country in question is less than 3 per cent. If safeguards exceed a certain level, the country that imposes them must compensate the exporting countries affected by, for example, reducing tariffs on other products. (The agreement does not currently fully apply to agricultural products).

During the Uruguay Round, the rules were amended so that countries would use the safeguard option in preference to anti-dumping action. The number of safeguard cases has increased somewhat since then, but is still much lower than anti-dumping cases.

The agreement on safeguards also forbids measures which previously lay in the grey zone to what was permitted, i.e. primarily various forms of so called *Voluntary Export Restrictions* (VER) which some countries have more or less forced other countries to impose. The VERS were particularly frequent in the OECD countries' strategy to limit imports of textiles and clothing during the old Multifibre Agreement, today abolished (see Chapter 9).

8.3.3 Subsidies and countervailing measures

Subsidies to companies can be introduced for more or less legitimate reasons. As subsidies risk distorting export prices, WTO has introduced regulations which discipline members' application of subsidies. WTO regulations apply only to so-called specific subsidies, i.e. those that are aimed at one or a particular group of companies. The Agreement does not currently fully apply to agriculture, as subsidies in this area are regulated in the agricultural agreement.

The Agreement on Subsidies and Countervailing Measures divides subsidies into two categories: prohibited and actionable. Totally forbidden are:

- subsidies contingent upon export performance. This ban does not concern LDCs or countries with a GNP of less than USD 1,000 per capita, as long as they have less than 3.5 per cent of the world market for the product in question, and
- subsidies contingent on the use of domestic raw materials. This regulation entered into force in 2000 for developing countries and 2003 for LDCs.

All other types of subsidies are permitted up to a certain level, and levels may be increased if they do not cause injury to other countries' domestic industries or have negative effects on their export markets. As other countries are able to question such subsidies, they are called *actionable*. A country which considers that another country grants subsidies in an illegal fashion may impose *countervailing measures* if it can prove that its own industries have suffered as a result. Such countervailing measures (for example some form of tariff) may not exceed the size of the subsidy and in practice usually lies under 10 per cent, i.e. considerably lower than anti-dumping duties.

If it cannot be proved that domestic industry has been injured, only that there is a risk that it will be hurt, or if the subsidies decrease the industry's export opportunities, countervailing measures cannot be levied. However the complainant country can invoke the dispute settlement procedures and possibly force the country providing the subsidy to cancel it. It is up to the country which has introduced the subsidy to prove that it does not create disadvantages for the industry of the complainant country. (The burden of proof is, however, reversed if the subsidising country is a developing country.)

Previously there was also a third category: "non-actionable", i.e. support that was, in practice, allowed. However these regulations (Articles 6.1, 8 and 9) ceased to apply on 1st January 2000, as it proved to be impossible to come to an agreement on prolongation which is required according to Article 31 of the Agreement. Included in these permitted subsidies were regional support, support to research and support to facilitate adaptation to environmental requirements, i.e. subsidies utilised primarily in industrialised countries. In actual practice, most subsidies with these objectives are still permitted.

The subsidies often used by developing countries, however, such as support for the diversification of exports or to introduce new technology, have never belonged to the permitted group. General subsidies (which do not apply to a certain sector but to, for example, all small enterprises) are still protected from countervailing measures, as several of the previously "permitted" types of support should be considered as general.

Before 1995, countervailing duties were primarily imposed by USA, Australia, Brazil and Mexico, while after 1995 they were mostly used by USA, EU and New Zealand. Overall, the use of countervailing duties has decreased. Only 33 investigations were carried out 1995–1998, as against 137 during 1992–1994, and the number has continued to decrease. The EU, South Africa and Brazil were the major targets for these measures in the 1990s (Finger and Schuknecht 1999).

8.3.4 LDC interests

As procedures for the application of safeguards, anti-dumping and countervailing measures are complicated and expensive, these instruments have never been used by LDCS (although LDCS have participated as third parties in several disputes where other developing countries have been directly involved as plaintiffs). As long as their exports remain too small to threaten other countries, it is hardly likely that they risk being the target of these measures from other countries either. At present it can therefore be stated that these agreements are less important to LDCS. However in the longer perspective and from the point of view of developing countries in general, it should be important to severely limit opportunities to impose anti-dumping duties.

Before the Uruguay Round, developing countries had much more freedom as concerns the introduction of subsidies. It can be noted, for example, that the successful Asian countries employed a wide variety of subsidies which were used to build up their export industries. Even if there are also a huge number of failed attempts in many parts of the world to use state subsidies in order to develop competitive industries, the degree to which WTO should limit developing countries' policy space by forbidding them to use this instrument in their development policies can be questioned.

Implementation of the Agreement on Subsidies and Countervailing Measures can be difficult for LDCS, primarily because they would be forced to phase out all subsidies which are contingent on the utilisation of domestic raw materials. Notification requirements could also be difficult to fulfil.

8.4 Agreements which regulate product requirements and regulations for health, plant and animal protection: the TBT and SPS agreements

The *SPS Agreement* regulates countries' opportunities to impose health requirements on imported products *(SPS = Sanitary and PhytoSanitary Measures)*. This agreement was adopted during the Uruguay Round and is a specification of Article 20b of the GATT Agreement. This article states that countries are permitted to impose measures that are "necessary to protect human, animal or plant life and health" provided that these measures do not constitute a means of "arbitrary or unjustifiable discrimination" or "disguised restriction on international trade". The SPS Agreement states that countries must primarily base their SPS measures on international standards, e.g. public health standards established within the FAO agency Codex Alimentarius. If countries wish to set stricter requirements they must be able to justify their demands with scientific evidence and risk assessments.

As LDCs in general do not possess the laboratories and inspection systems necessary, they often experience difficulties in fulfilling the increasingly high levels of health requirements set by industrialised countries on imported products. Many developing countries fear that SPS requirements will be increasingly imposed for protectionist reasons, in pace with the imposition of tighter discipline as concerns the use of other protectionist measures by industrialised countries (anti-dumping, safeguards, etc). The SPS Agreement, from this perspective, provides an improvement for developing countries as it primarily disciplines the product requirements of industrialised countries. International harmonisation also lies in the interest of developing countries as it makes it easier for their producers to adapt to the requirements of other markets. At the same time the actual implementation of the SPS Agreement can be both expensive and difficult for countries. LDCs which have their own SPS regulations which are stricter than international standards will, after this agreement enters into force, have very little chance to maintain these as they generally lack sufficient resources to be able to present scientific justification for their regulations.

The *Agreement on Technical Barriers to Trade* (TBT) aims at ensuring that technical regulations, standards and procedures for assessment of conformity do not create unnecessary obstacles to trade. This agreement concerns all product areas and all technical regulations except the specific risks covered by the SPS Agreement. And, as with the SPS Agreement, international standards are preferred. However, requirements for scientific justification in order to set stricter requirements are not as severe. When the original TBT Agreement entered into force in 1989, only 40 countries signed it. In the Uruguay Round, the Agreement was expanded to cover all WTO members; it is part of the "single undertaking".

As far as technical regulations are concerned developing countries also benefit, in principle, from the international harmonisation stated in the Agreement. Many developing countries have, however, experienced difficulties in implementing the requirements of the Agreement within their own government authorities and standardisation agencies as concerns reporting procedures etc.

Both the TBT and the SPS agreements contain undertakings concerning technical assistance and promises to take the interests of developing countries into consideration when establishing international norms and standards. However, there is a general mistrust in many developing countries as concerns international agencies such as the International Standardisation Organisation ISO, who they feel base their operations solely on the needs of the industrialised countries.

8.4.1 LDC interests

LDCs have requested that the opportunity of setting product requirements which are stricter than international norms be further limited. They also demand clear commitments as concerns technical assistance and that international norms and standard setting must take their interests into consideration more consistently.

It is obvious that LDCs need more development assistance in order to be able to fulfil the technical requirements of export markets. International harmonisation should, meanwhile, proceed at a reasonable pace – different types and levels of risk assessments will continue to exist in the various countries so, for example, different health standards must continue to be permitted. In many cases, however, it should be possible to adapt requirements to the preconditions of developing country producers without lowering standards. If high standards are not maintained there is a risk that consumer confidence will decline and developing countries will not be able to sell their goods anyway. This aspect is increasingly highlighted by the representatives of the developing countries themselves (see, for example, Zarrilli, 1999).

8.5 The TRIMS Agreement

Development effects of foreign investments can, in certain cases, be reinforced if foreign companies use local resources and interact with local economies. Many developing countries therefore attempt to control the actions of foreign investors by linking special conditions to investment permits. The TRIMS Agreement *(Trade Related Investment Measures)* limits countries' opportunities to set such conditions if they are directly connected to trade. The Agreement forbids, for example, requirements for "local contents" and that the company must export a certain part of their production.

TRIMS in itself does not contain any new prohibitions, actually it is a developed interpretation of previous GATT regulations. According to TRIMS, all countries that impose forbidden measures must report them, and then dismantle their system over a period of two years (industrialised countries) or five years (developing countries) or seven years (LDCS). Longer transitional periods can be granted on a case-by-case basis. Of the investment measures prohibited by TRIMS it is probably the requirement for local contents which is currently most prevalent and which will be most difficult to phase out.

The ban is motivated by the fact that these investment conditions risk distorting trade and limiting international investments. The requirements developing countries place on foreign investors are regarded, in other words, as counterproductive as they risk scaring off essential investors. It should, however, be pointed out that there are both positive and negative examples of these investment measures. As in so many other cases it is impossible to say that a certain tool is always right or wrong, the main point is how it is used – i.e. primarily the intentions and capability of the government of the country in question. It can also be noted that several industrialised countries have used similar instruments during their own industrial development period. Especially USA who, up until the mid-90s, repeatedly required that foreign companies begin in-country manufacturing when they had obtained a certain share of the US market.

It could therefore be questioned why WTO would refuse developing countries the right to use the same instruments of industrial policy that many of present day industrialised countries used for long periods of time. LDCS have also argued that they should be allowed to retain local contents requirements in the future.

The discussion on investment regulations in the section covering possible new negotiation rounds (Chapter 15) is also of interest here. The OECD countries, and in particular the EU, have consistently tried to move investment issues up the WTO agenda, and in the plethora of bilateral trade agreements, investment clauses, which often serve to guarantee the rights and liberties of foreign investors, are regularly included.

8.6 Customs valuation and other more technical agreements

In addition to the agreements discussed above, several others which dealt with trade in goods were concluded during the Uruguay Round, most of them of a fairly technical nature. When components are manufactured in a country other than that where the final assembly takes place, it can be difficult to establish exactly where it was manufactured. *The Agreement on Rules of Origin* is aimed at harmonising the methods by which WTO members are to classify the origin of goods. However, it does not aim to harmonise the rules of origin used within tariff preference systems such as Generalised System or Preferences, GSP and the Lomé and Cotonou Agreements which play an extremely important role for LDCS' opportunities to benefit from special tariff reductions (see Chapter 13).

Certain developing countries require an inspection of goods before they are imported instead of, or as a complement to, the checks normally carried out by customs authorities. In certain cases this would be a method of fighting corruption in harbours and guaranteeing that the goods are actually delivered. The *PSI Agreement* (Pre-Shipment Inspection) has been established on the initiative of industrialised countries, and regulates opportunities to require PSI. The aim is not to allow PSI to cause unnecessary delays. In addition there is the agreement on *customs valuation* which states the method to be used when calculating tariffs, and one on *import licensing procedures.*

Finally the Uruguay Round included several plurilateral agreements, i.e. agreements which do not cover all WTO members (and which therefore were not part of the *"single undertaking"*): agreements on *government procurement*, *dairy products*, *bovine meat* and *trade in civil aircraft*.

Trade and agreements in textiles and clothing

CHAPTER 9

9.1 World trade in textile products

Developments in the textile and clothing products trade vary from year to year, and trade patterns are undergoing substantial transformation.

During the period 1990–1998, a total increase in value of 72 percent occurred in trade in clothing and 55 percent in trade in textiles. Between 1999 and 2004, the increase was 25 percent in textiles, and 28 percent in clothes.

The share of exports from OECD countries has been declining drastically over the past few decades. As late as in 1998, Germany and Italy were the two largest exporters of textiles and clothing in the world. At present, China and Hong Kong are occupying these positions, and the role of China is increasing continuously in the wake of the dismantling of the Multifibre Agreement (MFA) in 2005 (see below). The twelve major exporters of textiles in 2004 were China, Hong Kong, Italy, Germany, Turkey, France, Mexico, Belgium, USA, Romania and Indonesia in that order. Among the twenty-one largest exporters there were a few additional developing countries namely Bangladesh, Thailand, Vietnam, Tunisia, Pakistan, Morocco and Sri Lanka (see Table 9.1).

Exports of textiles and clothing from LDCs are marginal in the global context. The only LDC that is on its way to creating a position for itself is Bangladesh, which also registers the world's highest share of textiles and clothing in its export trade: over 60 percent of the value of merchandise exports.

Many LDCs, not least in Africa, which used to have small but quite profitable niches on developed country markets thanks to the MFA quotas are today deeply concerned about competition from China and other Asian countries. While there is no reason to deplore the disappearance of the infamous MFA, the loss of the competitive advantage enjoyed by a number of LDCs and other developing countries until 2005 may be regarded as a special case of preference erosion.

Table 9.1: Clothing and textile exports by largest exporting countries, 2004

Exporting country	Value (millions US$)	Share of world (%)
China	95 284	21
Hong Kong, China	39 393	9
Italy	33 125	7
Germany	24 803	5
Turkey	17 622	4
United States	17 049	4
France	15 221	3
Belgium	13 905	3
Pakistan	12 249	3
United Kingdom	10 184	2
Mexico	9 434	2
Netherlands	8 416	2
Japan	7 749	2
Indonesia	7 606	2
Thailand	6 675	1
Romania	5 279	1
Bangladesh	4 830	1
Total, top 17	328 823	73
Others	107 878	27
World	452 829	100

Source: WTO Trade Statistics, web, June and September 2006.

9.2 Textiles and clothing policies in GATT and WTO

Trade in textiles and clothing was first regulated when new Asian manufacturers entered the international arena. As early as the late 1950s, USA signed a bilateral agreement with Japan and other textile exporters in South East Asia to restrict imports. The 1960s saw the first agreement within GATT which covered cotton textiles. Textile manufacturers in the industrialised countries felt threatened by growing competition from an increasing number of developing nations who were able to offer far lower prices (for a useful overview of pre-MFA restrictions, see Naumann, 2006).

In Europe, quantitative restrictions on certain imports went even further, covering most of the textile and clothing sector. In general, the restrictions were defended with reference to the safeguard clause in the GATT agreement (Article XII, "Restrictions to Safeguard the Balance of Payments").

Between 1974 and January 1st, 2005 trade in textiles and clothing was largely governed by the MFA. This agreement legitimised the introduction of import restrictions by industrialised countries on textiles from developing countries with competitive textiles industries. Within the framework of bilateral agreements, "voluntary restrictions" were also fixed for exports from developing countries to each industrialised country. A comprehensive licensing system governed these restrictions.

9.3 The Agreement on Textiles and Clothing (ATC)

The MFA was in obvious breach of basic GATT principles, including Article I ("Most Favoured Nation Treatment") and Article XI ("General Elimination of Quantitative Restrictions"), which prohibits all forms of quantitative restrictions, licences and quotas except under highly exceptional circumstances related to food security.

During the Uruguay Round, developing countries demanded that industrialised countries implement liberalisation measures especially in the areas of textiles and agriculture. While results were meagre in agriculture, negotiations led to a resolution that the special treatment of the textiles sector must be eliminated over a ten-year transitional period as regulated in the Agreement on Textiles and Clothing (ATC) which entered into force on 1st January 1995. ATC thus signalled the long overdue removal of the complicated system of licences, quotas and "voluntary" export restrictions that characterised the MFA.

The Agreement on Textiles and Clothing (ATC) stated, among other things,

- that all quantitative import restrictions on textile goods, which had been permitted within the framework of the MFA, must be successively abolished over a ten-year transitional period,
- that the subsequent trade in these products should adhere to the prevailing rules in the GATT agreement and
- that both finished and semi-finished products (i.e. both wool yarn and blouses) must be included in all steps towards deregulation.

During the transition period, industrialised countries had the right to employ specific protection mechanisms that permitted the re-introduction of certain restrictions. Such safeguards could be adopted against individual exporting countries if the total import of the products concerned surged or if an increase in imports caused serious difficulties for domestic industry. A special body, "The Textile Monitoring Body" (TMB) was set up to monitor developments within the trade in textiles and clothing.

The gradual deregulation of the current special treatment of the trade in textiles and clothing was to be carried out as follows:

- From 1 January 1995, textile goods to the equivalent of not less than 16 per cent of each country's 1990 imports by volume were to be integrated into normal trade conditions;
- From 1 January 1998, a further 17 per cent of 1990 imports by volume were to be integrated into normal trade conditions;
- From 1 January 2002, a further 18 per cent were to be integrated, and
- From 1 January 2005, all remaining products must be integrated into the normal trade regime.

Compliance turned out to be much slower than anticipated in the schedule agreed upon, however, as most OECD countries dragged their feet in abolishing quotas and other restrictions. Behind the obstruction of the ATC stood powerful industry organisations in the rich countries wanting protection plus a number of middle and low-income countries such as Turkey, South Africa, Lesotho, Bangladesh, Swaziland and others who feared competition from China. The intense lobbying also resulted in an initiative called the "Istanbul Declaration" in which a three-year extension of MFA quotas was proposed.

The Istanbul Declaration was rejected, but by December 2004, well over fifty per cent of the value of textile and clothing products was still subject to quantitative restrictions on the EU and US markets (the ATC only presented a time-table for volumes and number of product lines not values, which opened the door for gross manipulation). One consequence of this slow implementation rate was that January 1st, 2005 came to be a "big bang" instead of, as envisaged, merely representing the final stage of a ten-year period during which importing and exporting countries had been expected to adjust to the new situation in a gradual manner.

It should be stressed that deregulation is still far from complete, in particular as regards Chinese exports. 2005 witnessed a wide range of almost desperate efforts from the EU and US to check the flow of imports from China and for a long time, huge volumes of Chinese textile products had to be stored in warehouses before they were permitted to enter the European and American markets. After certain Chinese concessions involving "voluntary" measures to reduce exports of certain products, the stockpiled goods were finally released, but safeguard instruments remain. Likewise, the agreement which gave China full member status of WTO also contained – contrary to the original scheduling – special clauses which permit countries to take trade-restricting action against any dramatic surge in textile and clothing imports from China that threatens "market disruptions" (a concept which is never defined, however).

9.4 The effects of deregulation

While it is still too early to analyse the consequences of the scrapping of the MFA, deregulation is expected to lead to many developing countries increasing their exports of textiles and clothing in the future. At the same time, and as indicated above, certain developing countries that had carved out small niche markets within the restrictions system run the risk of losing these after deregulation. This mainly applies to manufacturers who make the same kind of products as China, but are less competitive than the Chinese.

The Swedish experience might be relevant in this context. Sweden has already felt the effects of deregulation in its textile sector in the first half of the 1990s as the sole industrialised country to abolish all restrictions on textile imports from 31 July 1991. However, when Sweden joined the EU a few years later the regulatory system was re-introduced. The few years with completely deregulated access to the Swedish market clearly demonstrated that China was the major beneficiary as large quantities of Chinese textiles could be offered immediately at low prices (greatly benefiting Swedish consumers). However, this Chinese success was not primarily at the expense of other developing nations, but rather of imports from Portugal. The developing countries whose manufacturing and cost advantages had been reduced, such as Hong Kong and South Korea, also lost market shares while India, Bangladesh and a number of other developing countries gained ground. Other losers included developing countries that had gained market shares solely due to restrictions on other countries. Examples of these include Malaysia and the Philippines.

Deregulation in Sweden also led to increased imports from Central and Eastern European countries. It is worth noting that these countries have become important suppliers to the entire EU since their exports were made totally tariff-free from 1 January 1998. Even before then, their textile exports to the EU rose significantly, mainly due to contract manufacturing for EU companies through the "Outward Processing Traffic" system (OPT). Even though the role of OPT is now decreasing, EU companies based in Central and Eastern Europe are likely to maintain a high market share of imports into the EU, possibly in certain sub-sectors of the textile-clothing value chain such as design, marketing and others, while simpler manufacturing stages may be outsourced to, for example, China.

The Swedish experiment showed how important deregulation of the textiles sector can be for many developing countries. The main losers have been industrialised countries and middle-income developing countries where manufacturing costs are too high.

To judge from developments in 2005 and early 2006, China has, as expected, increased its exports dramatically. India and Pakistan have also enhanced their role in global exports of textiles and clothing, while suppliers from Latin America and Africa have lost market shares (ICTSD, *Bridges*, November 2006).

9.5 Remaining barriers to trade in textiles and clothing

The elimination of quantitative restrictions does not mean that imports will not liable to tariffs. Nonetheless, a cautious liberalisation is expected to continue also on the tariff side. Tariffs that ranged from 13–19 per cent in the OECD countries in 1995 were reduced to an average of 12 per cent by 2005. Developing countries enjoying duty-free access to OECD countries – such as all LDCs to the EU market – are therefore likely to see the benefits of their privileged access becoming further eroded.

The key remaining obstacles to trade in textiles and clothing are not related to tariffs, however, but rather to non-tariff barriers to trade.

The continued existence of safeguard clauses is a constant threat to highly successful exporters. While safeguard measures have so far never been applied against an LDC, they do represent a potential threat to the agreements reached on a world trade in textile products free from quotas and quantitative restrictions.

Anti-dumping measures represent a perhaps even more serious threat. 2005 witnessed a considerable increase in anti-dumping investigations from the EU, and as in previous years, Asia was the biggest victim, attracting 16 of the 24 new anti-dumping investigations, half of these being against China (FTA, *Annual Report 2005–2006*, p. 12). The number of so-called provisional measures, running for six months during investigation, also increased. Several of the anti-dumping charges have concerned textile products.

The case receiving most publicity in 2006 has been the EU's decision to apply higher duties on shoes imported from China and Vietnam because of these countries' alleged dumping. While no LDC has so far been subject to punitive tariffs because of dumping, the fact that low-income countries such as India, China and Vietnam are frequent targets highlights the fact that the Agreement on Textiles and Clothing is no guarantee against the use of a wide range of protectionist policies under the guise of anti-dumping.

For LDCs, the perhaps most important obstacle is related to the complicated principles of rules of origin discussed earlier. Even though the LDCs are already permitted duty-free market access for industrial products on many industrialised country markets, including the EU, they cannot always take advantage of this due to the structuring of the rules of origin criteria in the different preference agreements with industrialised countries. The requirements stated for freedom from duties within the textiles sector are also more extensive than for other industrial goods. It is not enough for the clothes to be sewn up in an LDC, the cloth must also have been sourced in the same LDC or industrialised country concerned. There are even requirements concerning the origin of the sewing machines used! LDCs often fail to meet these criteria, as illustrated in the case of Bangladesh below.

Case study: For a number of years Bangladesh exported cotton shirts to the EU and enjoyed duty-free market access. However, during a check by EC customs authorities it was discovered that the shirts did not meet the rules of origin criteria, and all importers involved then had to pay retrospective duty on every shirt imported. Bangladesh does not have the industrial infrastructure required to manage every stage of production from producing the thread and weaving the cloth to sewing the finished garment, and can only manage the final sewing stage. If the country were to purchase primary materials from the EU, the only option available under the prevailing rules of origin, the shirts would be too expensive. The rules of origin would have to be modified for Bangladesh to continue exporting cheap shirts duty-free.

In this case, the EU decided to modify the rules of origin so that the use of regional primary products would be permitted. Otherwise, manufacturing would have had to be abandoned.

The EU rules of origin regulations have been met with sharp criticism from developing countries over the years, not least because of the complicated mix of processing criteria and value shares which in practice has made it difficult or impossible to take full advantage of all potential preferences. The situation made reforms essential, and the European Commission has recently devised a new, uniform approach based on the share of net product costs incurred in the exporting country concerned.[22] Under this new proposal, a final product from one country using raw materials or semi-finished inputs from another country would be considered as originating from the exporting country if the value added in the country (or in another country having preferential status – so-called tariff cumulation) exceeds a certain threshold. There is, however, no uniform percentage – different rates are applied according to country and sector.

To make things more complicated, the US – under AGOA, the African Growth and Opportunities Agreement – and Japan have their own rules of origin, which differ from those of the EU.

The textiles and clothing sector in many LDC is particularly affected by the rules of origin as many LDCs cannot produce the machinery and equipment used by the textile industry or the raw materials – e.g. cotton – but have to import such items from countries which may not be covered by duty-free access to OECD markets.

Another threat is the EU decision to enforce regulations which make it imperative to label specific imported consumer goods with the country of origin (if the exporting country is outside the European Union). While consumers in many cases have a legitimate right to know where certain consumer goods, such as foodstuffs, have been produced, the aim of the compulsory origin labelling requirement is clearly to discriminate against imported goods. In the case of textiles and clothing, origin labelling is complicated, in view of the many different countries that are often involved in the production chain. In practice, the EU regulation can be regarded as additional red tape, i.e. a further barrier to trade which will mainly affect low-income countries with weak trade and customs administrations.

Somewhat different in objectives, but with similar consequences, are the demands for eco-labelling and "fair trade" labelling in many OECD countries. While this may again be a legitimate consumer demand, the

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22 This paragraph is largely based on Foreign Trade Association (FTA), Annual Report 2005/2006, Brussels 2006.

textile industry is particularly vulnerable to accusations of, for example, using child labour or causing environmental damage in the early phases of the production cycle. Such accusations, whether true or not may, as in the case of stricter requirements for pre-shipment inspections and other administrative demands on exporters, also be used as protectionist measures which low-income countries can have great difficulties in coping with.

9.6 Consequences for LDCs

It is open to debate how well African developing countries will be able to survive in the face of international competition in the textiles sector. The dismantling of the MFA, plus the general reduction in tariffs on textiles and clothing that has taken place, has served to reduce the competitive advantage enjoyed before 2005 by ACP and AGOA countries on the EU and US markets, respectively. Several African LDCs such as Lesotho have already seen their textile industries suffer badly as a consequence of the loss of quotas. There is a major risk that they will not be able to compete with countries like China.

It is also uncertain whether domestic textiles industries in Africa are strong enough to compete on their domestic and regional markets in the future. Local African markets are already being flooded by goods originating from China and other Asian countries, and global developments in trade with garments may represent more threats than opportunities for LDC industries.

One possibility could be for the African LDCs to be given the opportunity to make clothing from imported Chinese cloth that can then be exported tariff free to the industrialised world. If this were the case, the OECD countries would have to amend current regulations concerning rules of origin of duty-free imports from LDCs.

Many developing countries and regional groupings, including COMESA the common market for Eastern and Southern Africa, are demanding assurances on a number of areas concerning future trade in textile products. Their principal demand is that all countries, and especially the industrialised countries, should abide by the Textile Agreement and refrain from protectionist policies. Concerning safeguards and anti-dumping measures, textile exporting developing nations want assurances from the industrialised countries that the latter will be restrictive in their application of these instruments. Calls have also been made for the promised measures to support small manufacturers in LDCs to be implemented.

Trade and agreements in agricultural products

CHAPTER 10

"Building on the work carried out to date and without prejudging the outcome of the negotiations we commit ourselves to comprehensive negotiations aimed at: substantial improvements in market access; reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support."
(Doha Ministerial Declaration, paragraph 13, 2001).

10.1 Agriculture's double role

Agriculture plays a double role in most LDCs: it is crucial for both exports and the domestic market. These twin roles should be kept separate when analysing the effects of trade on agriculture.

The exports of some twenty LDCs are totally dominated by agricultural products or fish and shellfish. However, there are currently many LDCs where agriculture makes up an insignificant part of exports – the dozen or so African countries with substantial mineral assets, the handful of Asian LDCs that have developed growing garment export industries plus the odd few countries that export large quantities of timber. There are also several countries which used to export substantial amounts of agricultural products but whose exports have stagnated so that they have gradually become net importers of food.

Agriculture is, however, fundamental to employment and food provision on the domestic markets of virtually all LDCs. Over two thirds of the populations of these countries, the vast majority small farmers or farm workers, are wholly or partly dependent on agriculture for their livelihoods. This group also includes the poorest sections of the population. If poverty alleviation is to be successful, it is vital to support these small farmers as there are few opportunities for them to find alternative employment in the short and medium term.

Small farmers typically account for a large proportion of staple food production, yet are often of marginal importance for export crops. Adopting the right policies nationally and internationally could provide major opportunities to increase productivity on smallholdings and thereby reduce poverty. This sector may perhaps not be crucial for exports, but it could at least supply staple crops to urban populations and make their countries less dependent on imports.

At the same time there are major difficulties associated with promoting the interests of small farmers with the help of an improved infrastructure and supportive institutions. There are numerous examples of unsuccessful attempts to do this, and the small farming sector is in crisis in many countries. Prices on the domestic markets have been depressed, partly due to imports of heavily subsidised food. In addition, overvalued currencies have in many countries indirectly taxed farming and harmed exports, and the needs of small farmers have been consistently ignored. Small farmers are weakly organised as a group and in most cases have little or no political influence.

The "green revolution", so successful in many Asian countries, has never made much headway in sub-Saharan Africa. While most structural adjustment programmes implemented in the 1980s and 90s had as an explicit objective of stimulating agricultural production with the help of, among other measures, price liberalisation, the results have been exceedingly disappointing. One consequence of the public sector's virtual withdrawal from support to agricultural development – in the form of reduced or abolished subsidies of fertilizer and other farm inputs, the dismantling of marketing parastatals, reduced public expenditure on agricultural research and extension, etc. – was that the smallholder sector lost most of the small-scale public support it may have had, while the private, commercial sector failed to fill the vacuum (for an interesting comparison between Asian and African attempts to achieve a "green revolution", see Djurfeldt et al., 2005).

The urban bias prevailing in economic policies in the majority of LDCs has also been reinforced by the lack of priority given to rural development by the donor community. The volume of ODA to agriculture in sub-Saharan Africa was reduced by more than fifty per cent between the early 1980s and late 90s, and despite a slight recovery of rural development assistance in the last few years, agriculture receives a very minor share of external resources in the form of grants or loans.

The destructive effects of OECD countries' agricultural policies are discussed in Section 10.3 below.

10.2 Trade in agricultural products

Trade in agricultural products forms barely nine per cent of total world trade, a share that has been falling since the 1950s when it was 38 per cent and 27 per cent in the 60s (WTO, *World Trade Report 2006*, p. 7). The developing world currently has a 25 per cent share of exports, compared with 40 per cent at the beginning of the 60s.

The global trade in foodstuffs has undergone substantial changes, in particular as regards the pattern between rich and poor countries. From having been net exporters of foodstuffs in the 1980s, developing countries have been registering large and growing deficits during the past two decades. It is primarily African exports that have declined in significance; sub-Saharan Africa is the only major region in the world where per capita production of food is lower today than 30 years ago.

In addition, several countries in North Africa and the Middle East have contributed to the rise in food imports in developing regions as demand has increased more than domestic supply.

Today the LDCs account for about one per cent of world food exports, and about 1.7 percent of all agricultural raw material exports. This development is primarily a consequence of agricultural stagnation in sub-Saharan Africa.

As an illustration of the dramatic dependency on food imports in Africa, it may be observed that sub-Saharan Africa imports over one third of its total consumption of cereals.[23] Or, formulated differently, imports to a large extent from rich countries, where less than four percent of the population work in agriculture, are presently covering the needs of the entire urban population of Sub-Saharan Africa as concerns basic grains. The approximately two thirds of the population who are farmers are, statistically speaking, unable to provide one single urban dweller with basic food.

For the LDC group as a whole, food imports have cancelled out well over fifty per cent of total export earnings since the early 1990s.

Import substitution in food production must become a key objective of economic policies in a large number of African LDCs.

International trade accounts for a tiny fraction of the total production of most agricultural products: 10–15 percent for cereals and other food crops, and less than five percent for animal products apart from powdered milk. Tropical plantation crops – coffee, tea, cocoa, palm oil, fruit and

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[23] Unless otherwise stated, data in this and subsequent paragraphs is taken from FAO, *The State of Agricultural Commodity Markets 2004*, or from FAO's web site http://www.fao.org

fibre crops – are more heavily traded internationally. In the case of coffee, international trade figures are as high as 85 per cent.

Groups of actors on the world agriculture products market

Natural exporters: USA, Canada, Argentina, Uruguay, Brazil, Australia and New Zealand have favourable climates and soils and are rather sparsely populated. They pursue large-scale intensive production with low production costs and are major exporters. Exports from the US are partially dependent upon subsidies. With the exception of the US, they are all members of the Cairns Group, a group of countries that act together in the WTO to liberalise trade in agricultural products.

European Union. The EU exports large quantities of grain and animal products. Production is based on an intensive use of fertilizers and pesticides and large imports of feedstuffs (soya beans, palm oil, fish meal and others). As production costs are comparatively high in most countries, exports are dependent upon government support.

Net importers in the North. Agricultural policies in Japan, Norway, South Korea and Switzerland are, as in the EU, characterised by large subsidies. Farmers are protected by very high tariffs, but do not produce surpluses for exports. Russia and several other East European countries are currently net importers but are potentially net exporters.

Net exporters in the South. Apart from Brazil, Argentina and other Latin American countries in the group of natural exporters, Thailand and Vietnam, in particular, are large net exporters of rice, fish and many other agricultural products.

Net importers in the South. This group includes many LDCs and around 20 other developing countries, mainly in Africa and the Middle East. Grain imports, in particular, are large and growing rapidly.

Largely self-sufficient countries. In the vast majority of developing countries, domestic production is around +/- ten per cent of national requirements. Generally speaking, most of these countries are not dependent upon agricultural exports and can balance grain imports against certain exports of cash crops.

Source: Based on Einarsson (2000) modified.

The industrialised countries and major developing country exporters like Brazil and Argentina mainly export feed crops, grain, livestock products and oil seeds. The developing countries are major importers of grain (they import, for example, 76 per cent of the wheat they consume), feed crops, and animal products. They export both "old" tropical products – coffee, tea, cocoa, rubber and sugar – and "new" tropical export goods such as vegetables and cut flowers.

The share of high-value products has increased rapidly, at the expense of more traditional commodities. For example, fish, shellfish, fresh fruit and vegetables today account for 20 per cent of the value of developing countries' exports from agriculture and fishing, i.e. more than twice the value of coffee, tea, cocoa and other tropical products combined.

The EU is the most important market for LDCs, and EU15 accounts for around 25 per cent of all LDC exports of agricultural products. China is, however, rapidly emerging as a very important trade partner. Exports from Africa – so far primarily oil and minerals, but also a number of agricultural cash crops – to China have increased fourfold over the period 2001–2005. South-south trade in agricultural products is, in general, increasing rapidly.

The LDCs are often totally dependent on a small number of export products. On average three products account for over 70 per cent of LDC export revenues. Exports are often dominated by coffee, cotton or fish although other products include sesame seeds, cocoa or tobacco. Consequently these countries often compete against each other on export markets where demand for these crops is stagnating.

The development of world market prices for agricultural products is discussed further in Section 10.3 below.

Global agricultural markets are undergoing a series of trend-based changes for technical, economic and political reasons (from Kydd et.al. 2000). These changes concern:

- Increased productivity in the OECD and Cairns countries as well as in South and East Asia.
- Demand for foodstuffs is affected by high rates of economic growth in Asia and by the urbanisation of all developing countries and associated changes in eating habits and preferences. Demand for animal products is growing fastest, which in turn increases demand for feed. This can create competition with the poorest countries' grain needs.
- Inadequate infrastructure in many developing countries, together with constantly decreasing long distance transport costs, means that urban demand is largely satisfied by imports rather than by domestic production.
- Import barriers are reduced, especially in the South, and internal markets are under deregulation which increases competition and decreases the role of government organisations.

- International supplier chains are developing that specialise in remote purchasing of specific, high value products such as vegetables and cut flowers.
- Trade in processed food is growing. This is estimated at around 75 per cent of the value of total agriculture exports from OECD countries. This illustrates the importance of tariff escalation and makes issues concerning health and safety and labelling requirements particularly urgent for developing nations.
- The rapidly growing importance of processing and branding companies who take the key decisions about what products should be produced and how the supply chain and logistics are to be organised (this issue is further discussed in Section 10.5 below).

To these broad tendencies could be added one rather recent phenomenon which is bound to have profound, long-term consequences and which may serve to strengthen the market power of farmers and landowners: the rapidly increasing demand for bioenergy in the wake of rising oil prices. In many industrialised and developing countries the acreage devoted to biofuels – for example the production of ethanol from maize or sugar cane – is expanding dramatically, and if present trends continue the price of land and various agricultural inputs (water for irrigation, fertilizers, etc.) is likely to increase, together with world market prices of many agricultural products. Environmental problems – such as declining water resources in China and other key countries, the threats to food production posed by global warming and others – are also likely to have a serious impact on future agricultural prices and trade patterns.

If oil prices continue to rise, the strong trend of the 20th century towards lower and lower transportation costs may be reversed, thereby enhancing the competitiveness of food production for nearby local markets in both industrialised and developing countries.

Against this background, the task of winning back the domestic market and feeding the urban populations is the greatest challenge facing LDC agriculture. However, as long as large-scale dumping of OECD country surpluses continues, it will remain an uphill battle in many of these countries.

10.3 The impact of industrialised countries' agricultural policies – the EU example

In 1999, the OECD countries provided over BUSD 80 in direct support for their own farmers, to which can be added export subsidies, tariffs and other measures that enable the price of agricultural products to be kept higher inside these countries than on the world market. In the same year, the value of the OECD countries' total support to their agriculture sector amounted to around BUSD 250. (Swedish Board of Agriculture, 2000). This was the equivalent of approximately five times the total annual ODA budget to all developing countries, or substantially greater than the LDCs' total GDP.

Despite a number of commitments to reduce agricultural subsidies, not least during the Doha Round, the situation has not improved at all. Agriculture is still the only sector in the WTO in which even direct export subsidies are permitted.

In absolute terms, total OECD country support to agriculture had, in 2004, increased to BUSD 378 and producer support that year was estimated to have increased to BUSD 279 (UNCTAD, *Trade and Development Report 2006*, p. 77). And while the European Union has reduced its directly trade-distorting agricultural subsidies, the tendency in the United States has been the opposite, especially after the "farm bill" that was passed by the US Congress in May 2002. At present, most US agricultural subsidies are distributed in the form of direct support in order to increase the production of individual crops, particularly maize, soybeans, cotton, rice and wheat. Maize alone receives almost half of all crop subsidies (*The Economist*, "Uncle Sam's teat", September 9th, 2006). Naturally, subsidies of this kind have a direct effect on world market prices.

In this context we will, however, examine EU policies in particular as the EU is the single most important actor in trade relations with LDCs.

The EU is the world's biggest importer and simultaneously the second biggest exporter (after the USA) of agricultural products. Major export products are grain, citrus fruits, dairy products, meat and processed foods, while imports are dominated by fruit and vegetables, fish, coffee, tea, cacao, feed crops and oilseeds. More than half of these imports stem from developing nations. Since the 1970s, EU has produced large surpluses. These surpluses are exported and, as world market prices are generally much lower than prices in the EU, these exports must be subsidised, i.e. the difference is paid out of the EU budget through the Common Agricultural Policy (CAP). At the same time, the EU protects its own markets with high tariffs.

In addition to tariffs and quotas, the EU – like all other OECD countries – also applies a number of regulatory measures such as Sanitary and Phytosanitary (SPS) regulations as well as safeguard mechanisms and high levels of domestic support which distort prices on domestics markets as well as on the world market. The large retail chains which have become important actors, and account for a high and rising share of all agricultural imports, also apply a number of environmental and other standards which are normally higher than those established in international agreements.

Thanks to the EU decision to allow duty-free imports of virtually all products from LDCs (the so-called EBA initiative), SPS regulations and other non-tariff barriers to trade are likely to become the most important obstacles that will hinder LDCs from increasing their agricultural exports to the European common market.

There are several reasons why the EU surpluses have become so large: technical progress together with high levels of price support have raised production, and feedstuffs are imported duty-free on a large scale. Duty-free trade of e.g. protein feeds was a condition for US acceptance of EU rules when the CAP was introduced in the 1960s and has been a contributing factor in the highly industrialised animal production industry concentrated in areas close to major import ports.

Large EU subsidies, for both exports and direct support to farmers, means that exported goods can be sold very cheaply, i.e. in practice dumped, on the world market. As the EU is such a major player on the market – it supplies, for example, half of the world's total exports of citrus fruits, and 20 per cent of global meat exports – the CAP depresses the world market price for many products. EU tariffs also help make world market prices lower as what cannot be sold on the European market must be sold on other markets instead, with attendant price reductions. The EU has an especially strong downward effect on world market prices for dairy products, a major effect on sugar, beef, grain and citrus fruits and a modest effect on other products. The EU regulations also "export" price variations that would otherwise arise within the EU, and so cause world market prices to fluctuate more.

The price-depressing effect of agricultural subsidies in the EU and other major OECD countries is one important factor behind the decline in world market prices that was registered during the last decades of the 20th century, and which is illustrated in Table 1 below.

Table 10.1: World market prices (in constant prices) of selected agricultural products 1981–83 and 2001–2002. Index 1961–63 = 100.

	83–83	2001–02
Bananas	58	51
Coffee*	104	21
Rice	78	21
Wheat	87	35
Cotton	87	27
Rubber	57	20
Butter	92	32
Maize*	80	31
Jute	38	22
Tea	52	33
Sugar*	72	26

* Index 1971–73 = 100.
Source: FAO, *The State of Agricultural Commodity Markets 2004,* Table 1, p 38.

This downward pressure on prices means that consumers in other countries enjoy cheaper goods and processing industries in other countries gain access to cheap raw materials. However, the most important and extremely serious effect is that farmers in other countries are forced to compete with subsidised imports which in the long term adversely affects food security.

Middle-income countries with high agricultural potential, such as Argentina, Brazil, South Africa and Thailand, are primarily interested in improved market access to OECD countries and higher world market prices. Most of the LDCs, on the other hand, have somewhat different interests: market access is less important, at least in the short term, and as regards food prices the politically important urban population benefits from cheap food imports, while agricultural producers suffer.

In the past, the OECD countries were able to utilise the lack of a common "South" position on agricultural trade; there are obvious conflicts of interest both between and within developing countries. To the great surprise of many observers, however, the 5th WTO Ministerial Meeting in Cancún in 2003 witnessed very strong unity among developing countries in their demands for a thorough reform of global trade in agricultural products, including improved market access and an end to trade-distorting subsidies.

As will be further discussed in Chapter 15, the suspension of the WTO negotiations in July 2006 was, to a very large extent, the result of a failure to reach an agreement on agriculture: the EU was reluctant to reduce agricultural subsidies as well as agricultural tariffs and other barriers to agricultural imports, while the US refused to make binding commitments to lower domestic support to its farmers and agro-businesses. A third factor behind the breakdown of the Doha Round, often stressed by OECD country representatives, was that important developing countries, including India and Brazil, did not accept a decrease in their tariffs on industrial products unless they gained much in return.

10.4 The real actors: companies

Simplistically, we talk of "countries" trading. In practice however, it is companies that do the exporting and importing. Agricultural trade is currently dominated by an oligopoly of corporations, i.e. most trading is carried out by a handful of companies that have the power to influence the market by controlling several supplier stages and manipulating prices paid to both growers and buyers. Morisset (1998) found that raw material exporters receive a decreasing share of the value of the finished produce, and points to the oligopolistic structure of the market as a possible reason for this.

The tendency for farm-gate prices to the producers of tropical commodities to stagnate while later stages in the value chain – mainly processing and distribution – absorb an increasing share of total value added is confirmed by a number of studies (see e.g. FAO, *The State of Agricultural Commodity Markets 2004*, pp. 300 ff.). For example, the share of the final retail price of coffee that accrues to growers fell from a peak of 35 per cent in 1976 to around ten per cent in 2003 (Asfaha 2005, p. 7). One reason is the fact that competition is much stronger among the sellers/farmers than among the buyers, and according to value chain analysis, profits tend to be distributed in accordance with the barriers to entry and intensity of competition at each stage of the value chain. As observed by Asfaha (*ibid*, p.4): "While raw agricultural products are supplied by large numbers of small-scale producers, there is a high market concentration at the processing and distribution stages.... these stages are often dominated by few vertically-integrated multinational corporations. This has led to an enormous asymmetry in bargaining power between producers, processors and distributors" (ibid. p. 4).

The market structure also means that a great deal of support to agriculture in industrialised countries never reaches the farmers. In practice, much of the export subsidies from the USA and EU ends up in the hands of the transnational agribusiness companies rather than going directly to the farmers. Other support to agriculture tends not to reach the farmers either, and goes to the purchasing companies, suppliers of primary materials or the landowners (land prices go up when support levels are increased, a process known as capitalisation).

In other words, it is not only government support and trade barriers that distort international trade in agricultural products. This must be an important point of departure when seeking to improve the way the market operates; otherwise there is a risk that all the benefits of deregulation will accrue to the transnational corporations rather than to growers and consumers.

Transnational corporations also play an ever-greater role in the seed trade, which is vitally important for global food security. It has been estimated that one third of the world's seeds comes from a handful of transnational corporations and are protected by patents or plant breeders' rights. One third comes from public breeders and the remaining third from the farmers themselves (Murphy 1999). The TRIPS agreement (see Chapter 12) will lead to more powerful patent protection in many markets and the TNC's control over seed may increase dramatically. The transnational corporations are currently concentrating on developing strains that are adapted to the companies' own pesticides rather than resistant to drought or other problems that are important for small farmers in the South. But even if this corporate research were to work more closely with the needs of developing countries and LDCs, the risks associated with a small number of companies dominating the market remain.

10.5 The effects of liberalisation of agriculture

The liberalisation of markets produces different results depending on the imperfections that originally existed in each market, in addition to any distorting trade barriers. When discussing the effects of liberalisation on agriculture, it is also worth noting that the costs that always arise for producers when forced to adapt to new circumstances are often particularly significant in the farming sector. This is due to the fact that a very large number of people are dependent on agriculture for their livelihood, and that it is difficult for them to adapt production quickly or to find completely new forms of employment.

It is also important to differentiate between different forms of liberalisation. Does liberalisation lead to a reduction in direct or indirect export support, or less protection for domestic production, or both? It is just as important to see who is doing the liberalising. Is it the developing countries or the North who are opening up their markets? It may also be more important to differentiate between the effects on the export and domestic oriented sectors rather than differentiating between the effects on LDCs and on other developing countries.

10.5.1 Liberalisation in the EU

Since there has not yet been a genuine liberalisation of agricultural markets in the industrialised countries (see below) any discussion of the effects liberalisation would bring about are bound to be speculative. In this section we consider the possible effects of liberalising the EU market, although liberalisation in Japan and the USA would also have major consequences for global trade.

Broadly speaking, less support and lower tariffs in the EU are expected to lead to less dumping of surpluses, higher world market prices and greater access to the EU market. In simple terms, farmers in the South would be the winners: those who can export more, but also domestic market producers who were previously at risk of losing out to cheap imports. Consumers and taxpayers in the North would also gain, while farmers in the North and consumers in the South (i.e. primarily urban populations) would be the losers.

However, supply constraints mean that farmers in the developing world would often be unable to take advantage of increased access to markets in the North. Properly functioning markets would be required to ensure that production in the developing world would gain from increases in world market prices, and this is precisely what is lacking in many low-income countries which are riddled with inadequate institutions and infrastructure, unclear property rights and shortage of capital and skills.

The simplified image of winners and losers is not very relevant to the LDCs, however. Firstly many of them, mainly African countries, are net importers of food and imports would become more expensive if world market prices were to rise. When, however, rising world market prices create greater incentives for the domestic production of grain, it often takes just a minor increase in productivity to reverse this import dependency.

In all LDCs, and in particular in sub-Saharan Africa where productivity has been virtually stagnant for decades, the potential for an increase in crop yields is huge, but largely untapped.

Secondly, thanks to the EBA initiative, LDCs already enjoy duty-free access to the EU market except for a few products (rice and sugar), but the impact appears to have been quite marginal so far, largely due to supply constraints, restrictive rules of origin and the existence of non-tariff barriers to trade. Also, even before the EBA, LDC exports mainly consisted of commodities where there was rather little trade protection in the North, for unprocessed goods at least, i.e. tropical crops that do not compete with subsidised crops from the industrialised countries.

As discussed earlier, prices and demand for tropical agricultural products have been low for many years, implying that many LDCs are in the unenviable position of on the one hand being dependent on export revenues from products to saturated industrialised markets where there is little potential to increase exports even, when the market is opened up, and on the other hand are increasingly dependent on imported foodstuffs that are cheap thanks to agricultural policies in the North.

As the EU is at present depressing the prices of staple foods such as grain and animal products, the biggest winners of deregulation would be those farmers whose produce is sold on local markets in LDCs. Plus, of course, a large number of middle-income countries, not least in Latin America, with a large export potential and who are suffering from both restricted market access – including tariff peaks and tariff escalation – and from low world market prices due to dumping of food surpluses by the US and EU.

The EU is actively pursuing the issue of "multi-functionality", i.e. it should be taken into consideration that agriculture makes a social contribution in a variety of ways over and above actual production: rural development and regional balance, food security, the preservation of biological and cultural diversity etc. They argue that this multi-functionality differentiates agriculture from other sectors and justifies both state support and special trade rules. The EU is particularly anxious to preserve the "European model" of family farms. The traditionally protectionist nations of Japan, Switzerland, Norway and South Korea have formed an alliance with the EU on this issue, and with a number of East European countries too, while several small developing countries (primarily small island states) have also expressed an interest. Talk of multi-functionality is, however, viewed with scepticism by many other countries who argue that its main purpose is to draw focus away from their dumping practices, which the EU cannot possibly defend. Even if the concept as such is accepted, the fundamental question remains: how can the positive contribution agriculture makes to rural development, biological diversity etc. be supported in a manner that does not distort trade?

Recent modifications of the CAP, the Common Agricultural Policy, represent a potentially major step in the right direction in that the new policies aim to de-link agricultural subsidies paid via the EU budget from actual production levels. Earlier, both price support and acreage payments were linked to a given product. After the latest reforms, this link is broken and an increasing share of CAP funds is being directed to landowning in itself, irrespective of production, provided that the land owners fulfil certain environmental, "multi-functional" objectives. Another element of the reform of the CAP is that individual countries have the right to channel part of the common funds according to their own priorities. Overall spending levels will, however, remain unchanged.

Since the most recent reforms were adopted in 2003, the EU has been arguing that decoupled support should be put into the non trade-distorting category ("green box") where there are no maximum limit or reduction commitments in the Agreement on Agriculture (see Section 10.6 below).

It is too early to assess the consequences of the CAP reform. Some observers predict that these reforms will have a strong impact on agricultural production, while others argue that European farmers will maintain their production on more or less the same level as before, albeit with considerable shifts between different crops.

10.5.2 Liberalisation of developing countries' own trade policies

While the debate on liberalisation in the North is hypothetical, there are already numerous, real-life experiences of liberalisation of agricultural imports in developing countries. In a study of the consequences of trade liberalisation on poverty and food security, the author examined 27 case studies from a total of 39 countries in Africa, Latin America and Asia (Madeley 2000). Only a handful of LDCs are affected, but these studies still show trends that are probably also valid for LDCs more generally. The liberalisation studied was that of trade policies of developing countries as a consequence of the WTO Agreement on Agriculture (AoA), structural adjustment programmes and regional agreements (Nafta). In most cases, and in the LDCs in particular, the structural adjustment programmes have led to more extensive liberalisation than that brought about by the WTO. Such liberalisation has not merely consisted of lower import barriers, but also reduced subsidies, the abolition of price controls and the privatisation of state-owned companies.

The general message from these and other case studies is that liberalisation has undermined food security for poor farmers who sell their produce on the domestic market. The winners have been found in the export sector above all, largely amongst international companies. Liberalisation has not, however, led to a diversification of exports.

The largest effect of liberalisation has been a major rise in imports. Produce from small farmers can no longer compete on local markets, even less so in towns where they face competition from cheap (often dumped) imports. Profitability is squeezed from two directions: production costs rise when subsidies on agricultural inputs are abolished, while product prices fall. The reduced profitability for these small farmers is devastating to food security. If growers are driven out without having any alternative source of income, it is little consolation that cheap imported food is available in the market place.

One of the clearest examples comes from the implementation of the Nafta agreement in Mexico. Fruit and vegetable growers, mainly large-scale growers in one specific region, have gained from the increased trade with the USA. At the same time, the import of maize from the northern neighbour has led to a large-scale displacement of small farmers. The country has gone from being self-sufficient in maize to importing 40 per cent, mainly from the US. Maize cultivation has been rapidly replaced by growing feed crops and rearing livestock for export.

The reforms moved export production to a higher priority, which led to more land and financial resources moving into this sector, and less to production for the domestic market. In turn, this has been a contributing factor to the undermining of food security. There is also a gender aspect to this type of development – in Africa especially women are responsible for traditional farming practices, while the men are more active in export-oriented agriculture.

Certain elements of these internal reforms have had positive effects on domestic production, primarily currency devaluations which have raised the prices of competing goods. In addition an end to monopolies has, in certain cases, increased opportunities for farmers to sell to various competing purchasers. In other cases, however, state distribution and marketing systems have been replaced by a vacuum. But even in those cases where deregulation of the domestic market has led to increased farm-gate prices for growers, this positive effect has often been outweighed by more expensive inputs.

In a more general analysis of the effects of globalisation on farming in the South, Kydd et al. (2000) emphasise that small farmers' possibilities of competing with larger corporations diminish. They are adversely affected by such factors as poor roads and transport, less accurate information about markets and prices and a lack of credit. Government and parastatal organisations providing extension services, sales of inputs and marketing outlets have, as mentioned earlier, often been abolished. These parastatals may well often have been inefficient, but they have not been replaced by private alternatives to any adequate degree. Nor is it likely that the private sector could be able to meet existing demand. According to the authors of the above mentioned study, a great deal more public interventions, organised cooperative selling etc. may often be required to prevent small farmers from being totally wiped out by imports and larger growers.

10.6 The Agreement on Agriculture (AoA)

When the Agreement on Agriculture (AoA) entered into force in 1995 it was the first time that agriculture, traditionally heavily protected on most markets, came under WTO rules and regulations. As one of the most important and toughly negotiated parts of the Uruguay Round, the agreement was largely an arrangement between the USA and the EU. The interests of the developing countries were, however, more prominent in the Doha Round although no major breakthrough was achieved before July 2006 when the Round (temporarily?) came to a halt.

10.6.1 Principal commitments in the Agreement on Agriculture

In this agreement, the countries undertook to decrease both import barriers and various other types of support. Briefly the Agreement states that:

– All non-tariff trade barriers (quotas, variable import levies etc.) are to be converted into tariffs, so called tariffication. These tariffs are subsequently to be reduced by an average of 36 per cent.
– The import opportunities that were available in the base period are to be retained through specific quotas (so called tariff quotas, in which the tariffs are lower). The importing country is also required to allow a minimum market access of at least 5 per cent for each individual product.
– Expenditure on export subsidies should be reduced by 36 per cent, and the volume that receives export subsidies by 21 per cent.
– Internal support, i.e. all support that does not subsidise exports is to be included in a regulatory framework and partially reduced (see box on the following page).

As requirements to reduce subsidies apply to existing forms of support, and no new measures of this type may be introduced, the right to provide trade distorting support measures falls to those countries that previously enjoyed such rights (i.e. mainly the industrialised nations).

The Safeguard Clause provides countries with an opportunity to levy specific supplementary duties if import prices fall below, or import volumes exceed, a certain level. This clause may only be applied to products covered by tariffication and by countries that have tariff reduction measures in place and who notified their intention to invoke this mechanism at the time of signing the agreement – in practice, mainly the industrialised countries.

Agricultural support in different coloured boxes

Different forms of agricultural support measures are categorised in the Agreement on Agriculture into different coloured boxes (based on traffic lights). Different rules apply for the different boxes.

The Red box was prohibited when the agreement came into force. This box includes e.g. variable import levies, i.e. tariffs that vary automatically when the price is changed.

The Amber box contains trade-distorting measures that conflict with the principle of the agreement but which members may retain subject to reduction. This group includes price support, subsidies for inputs and certain forms of investment support. New support of a similar nature may not be introduced.

The Green box contains support that is "de-coupled" from production and considered not to distort trade. It includes support for research and rural development, food aid, environmental support and certain investment support. These forms of support are permitted until further notice.

The Blue box was added to the AoA after an agreement between the US and EU when several types of support were moved here from the Amber box. These include support linked to production-limiting programmes (common in the EU) and other types of support which are categorised as being neither trade distorting nor the opposite, and are permitted for the time being.

Much of the technically complicated negotiations over the Agreement on Agriculture has concerned in which boxes different forms of subsidies should be placed.

10.6.2 Special and Differential Treatment (SDT) of developing countries

The AoA also includes SDT regulations in a number of areas. Firstly, developing countries do not need to reduce tariffs, export subsidies and internal support as radically (2/3 of the level of the other countries). Certain specified SDT support measures may be retained in their entirety, for example, support for rural development and subsidised inputs for farmers with low incomes. All support below the so-called *de minimis* rule of ten per cent of product value is allowed (compared with five per cent for other countries). Of all these special regulations, only the tariff commitments and, in certain cases, the *de minimis* rule are of genuine significance, as export subsidies and other support measures available in developing countries are extremely limited.

The developing countries have a period of ten years to implement the agreement, compared with six years for other countries. The LDCs are totally exempted from reduction undertakings. On the other hand, they must convert import quotas, if applied, to tariffs and bind them.

In connection with the signing of the Agreement, a specific resolution of ministers was adopted for LDCs and Net Food-Importing Developing

Countries (NFIDC), the Marrakesh Resolution. The background to this resolution was that the AoA was expected to lead to higher world market prices and consequently difficulties for poorer countries which had become dependent on cheap food imports. The resolution includes a commitment to establish a mechanism to ensure that the Agreement does not impact negatively on access to food aid. To date, the resolution has not resulted in any concrete actions, partly because it is difficult to prove that the agreement has led to any negative consequences. Costs for importing countries may have risen, but this is not due to a rise in world market prices. It was more probably caused by a decrease in food aid and an increase in the need to import.

The developing country proposal from 2004 to introduce a Special Safeguard Mechanism (SSM) and an additional SDT option to protect domestic agriculture and food security is discussed in Section 10.6.5 below.

10.6.3 The effects of the Agreement on Agriculture

The major advantage of the AoA is that it forces countries to convert various different import barriers into tariffs which are more transparent. It is now possible for the first time to compare import barriers in different countries.

In practice however, tariff reductions have been very modest. As world market prices were exceptionally low during the base period, the bound tariffs became very high when quotas were transformed into tariffs (tariffication). There were also wide ranging opportunities to spread these tariff reductions amongst different product groups so that tariff cuts were less significant. The industrialised nations have been most adept at exploiting these opportunities.

In the industrialised countries in particular, tariff levels on individual products are often very high, the tariff peaks. This mainly applies to dairy products, sugar, grain, fruit and vegetables plus processed foods where in certain cases tariff peaks can be several hundred percent. The range of different tariff levels has increased, which is a problem in itself as this distorts relative prices in the agricultural economy.

Tariff escalation remains significant. In the EU, escalation is high for dairy products plus for fruit and sugar-based products such as juice, jam etc. In the USA and Japan it mainly affects dairy products and sugar. The significance of tariff escalation increases with the growth in trade in processed foodstuffs, and results in a larger proportion of the added value accruing to industrialised countries.

Total levels of support in the OECD countries have risen since the Agreement came into force, which means that the requirements to reduce internal support measures have led to a redistribution, rather than a reduction, of these types of support. Above all, reform of the CAP of the EU has meant that export subsidies and other market price support measures have been transformed into direct support (Blue Box support measures), which are permitted for the time being. Of the commitments to reduce support measures, only the requirement to cut export subsidies has forced the EU to introduce specific measures. However, these subsidies continue to be significant; over the past few years the EU has been responsible for around 85 per cent of total expenditures on export subsidies around the world. Comparisons are however difficult to make since export subsidies can assume many different forms; in the US, for example, most export subsidies are given in the form of subsidised export credits.

One of the few specific commitments made at the WTO Ministerial Meeting in Hong Kong in December 2005 was to eliminate all direct export subsidies by the year 2013 (see further Chapter 15).

Most developing countries have bound their tariffs at a much higher level than they themselves levy, which has enabled them to retain a degree of flexibility and the option of introducing greater protection for domestic producers in the future, if e.g. world market prices were to fall. Around half of the sub-Saharan African countries have bound their tariffs at over 100 per cent on average, but currently apply much lower levels. However some countries have committed themselves to lower levels, including some LDCS which have bound their levels at 50 per cent or less. The majority have already abolished internal support measures and subsidies as part of structural adjustment programmes. The demand for minimum access (four per cent) appears minor but can have a noticeable effect on markets in many developing countries as trade plays such a small part compared to the total production of many products.

To summarise, from a developing country perspective there are a number of imbalances in the WTO Agreement on Agriculture:

- The OECD countries' agricultural subsidies have been maintained and even increased;
- Many of the industrialised nation undertakings were very vague. In practice, market access has barely increased, except for LDCS benefiting from the EBA initiative and African countries benefiting from preferences on the US market as a result of the African Growth and Opportunities Act, AGOA (see Chapter 14);
- Developing countries have bound their various types of support measures at low levels and made tariff reduction commitments.

– Broadly speaking, only industrialised countries are able to invoke the Safeguard Clause.

This imbalance is illustrated by, for instance, the fact that in practice the Agreement has "legitimised" a situation where all Blue Box support measures, 96 per cent of all Amber Box support measures and virtually all export support benefit only four per cent of the world's farmers, namely those who live in the OECD countries (Swedish Board of Agriculture 2000).

10.6.4 New negotiations on agriculture: general issues

New agricultural negotiations were initiated in 2000 based on the mandate in the Agreement on Agriculture. According to this mandate, the aim of the negotiations was to continue reductions in import barriers and support measures in such a way that market access would increase most for developing nations. At the same time, non-trade concerns were to be taken into consideration. These non-trade concerns include the environment, food security, rural development and food safety.

A number of issues are open to negotiation: will Blue Box support measures continue to be accepted, even though they also affect trade? Will export subsidies be prohibited completely or merely reduced? Will the rules cover both the direct export grants provided by the EU and also the advantageous export credits available in the USA? Will the Peace and Safeguard clauses remain in some form?

The Cairns Group, an association of 17 developed and developing countries (but no LDCs) which are all highly competitive agricultural exporters, has worked consistently to achieve totally free trade in agricultural products. They are calling for the abolition of all export support measures (including export credits) and point to the fact that export subsidies to manufacturing industry were banned 40 years ago. They also demand an end to both Amber and Blue Box support measures and require that stricter criteria should be developed for Green Box support measures.

During the 1990s, the USA reduced its own subsidies, thereby moving closer to the Cairns Group position. However extremely low world market prices in 1998 resulted in new support measures, consequently the US position is no longer quite as clear-cut. President Bush's "Farm Bill", approved by the US Congress in May 2002, represented another step in the direction of increased subsidies.

The EU is basically split between interest in promoting the expansion of its exports and a desire to protect its own producers. As the CAP reforms already agreed are not far-reaching enough to meet the demands of other countries, they will be forced to adopt a mainly defensive stance. To date, the EU has expressed a willingness to reduce export subsidies if other types of export support are also reduced, i.e. export subsidies and the hidden types of export support measures that are available through state trading enterprises. They are also prepared to discuss continued cutbacks in Amber Box support measures, as long as the Blue and Green measures are allowed to remain. They also wish to retain the Peace and Safeguard clauses.

The greatest opposition to liberalisation can be found in countries not blessed with naturally favourable conditions for agriculture, but which nonetheless are anxious to maintain a high level of domestic production. Japan, Norway, South Korea and Switzerland are the most prominent of these members of the so-called G10 group, and they all apply very high import barriers.

Somewhat more surprising, perhaps, is the fact that France – with excellent conditions for a highly competitive agriculture – also belongs to the most ardent defenders of the EU's highly protectionist policies (France is not a member of the G10, however).

The developing countries do not act collectively in agricultural negotiations. Several are members of the Cairns Group, although some of these countries are net importers in practice and joining the group has been politically controversial at home.

More than anything else, the majority of developing countries are disappointed to have seen so little increased market access in the North as a result of the current agreement, while at the same time many of them are experiencing problems implementing their own commitments. LDCs and net importers are mainly working towards the payment of compensation for future price rises in accordance with the Marrakech Resolution. No concrete proposals have been put forward to date, but it is conceivable that a special fund could be set up and that support would be triggered if the world market price climbed above a certain level. Another alternative would be for donor countries to build up reserves. In terms of market access, the LDCs have demanded that they should never be hit by safeguard measures.

Developing country positions have been articulated more clearly through claims that Green Box support measures, the only ones that are permitted in their entirety in the Agreement on Agriculture, also distort trade. Another developing country proposal is that all forms of support should go into one big box, and that the same criteria should apply to all of them.

Developing countries have also demanded that all forms of dumping, both direct and indirect, should be banned, and that the industrialised countries should eliminate tariff escalation and tariff peaks.

10.6.5 New issues: Cancún and after

At the Cancún Ministerial Meeting in 2003, a powerful group of developing countries, the G20 – later labelled "G20 plus", as a result of a number of new countries joining the group – came forward with very strong positions, demanding thorough reforms of the industrialised countries' agricultural policies. Frustration over lack of progress was widespread. Another group that had been set up earlier was the G33 – composed of around 40 countries and led by Indonesia – which primarily focused on food security, rural development and livelihood security.

In addition to the old, unresolved issues, this latter group suggested a couple of new modalities, one called "Special Safeguard Mechanism" (SSM) and the other "Special Products" (SP).

The July 2004 WTO Framework Agreement on Agriculture accepted the idea of introducing a Special Safeguard Mechanism against import surges of agricultural imports and depressed import prices. The SSM, which would apply primarily to particularly sensitive products – SPs – would be available to all developing countries and would, in principle, remain in place until the particular problem was over. To prevent abuse, however, there should be a limit to the number of products on which a country can simultaneously apply protective tariffs.

In December 2004, the forty-odd members of the G33 group presented a detailed proposal asking for improved safeguard mechanisms whose requirement included that SSM measures should be available to all agricultural products and that both additional duties and quantitative restrictions could be envisaged as measures to provide relief from import surges and a decline in import prices. In order to avoid the cumbersome procedures laid down in the normal GATT safeguard mechanisms, according to which a member country must prove injury to the domestic industry and establish through an investigation that there is a causal link between increase in imports and injury, the G33 also argued that the SSM could be triggered automatically when import volumes rise above a certain level, or if prices fall below a certain level.

The G33 proposal on Special Products has met with resistance from a number of developed countries – the US, for example, has demanded that the SP designation be limited to no more than five products in each country, and that only products that are produced domestically or are close substitutes for domestic products can be eligible for the SSM provisions – but the principle of allowing additional safeguards measures for Special Products has been endorsed by the WTO. Certain food-exporting developing countries such as Thailand have also argued for restrictive conditions to be attached to the use of SPs, and the issue is one of many stumbling blocks for when the WTO negotiations on agriculture are resumed.

10.6.6 Conclusions

As the majority of the world's poor live in rural communities in developing nations, all trade policies that are designed to alleviate poverty must seriously consider how various changes affect populations there.

Small farmers who mainly market their produce locally are those hardest hit by industrialised nation dumping as they produce goods that compete with those of the industrialised world. Consequently they will also have most to gain from lower subsidies in the North. On the other hand, they will, for reasons discussed earlier, have great difficulties in exploiting the opportunities for increased exports offered by improved market access in the North.

Small farmers must be given the tools to meet the increased competition that will follow when developing nations lower their import barriers. The adjustment costs of liberalisation can be extremely high. For large parts of the population employed in small-scale agriculture it may not be possible to find alternative employment other than in the longer term. Their food security is threatened, even though there may be food available in the market place at a reasonable price. Yet many developing countries opened up their markets before they were ready. Small farmers in LDCs and other developing countries have therefore only felt the effects of their own countries' liberalisation so far, which has meant that they have been forced to compete with cheap, often dumped, imports.

Liberalisation in LDCs has largely favoured the production of cash crops, which often compete for resources with local production. While this development is highly encouraging, in many respects, it can also have a negative impact on production for the domestic market and risk food security.

Small farmers in the LDCs will not, in the foreseeable future, be able to compete with wheat from Argentina or rice from Thailand. Tariff barriers to create incentives for local production might therefore be needed in the South even if dumping from the EU and US ceases. Tariff barriers are, however, expensive for urban consumers and others. The interests of various groups must be weighed against each other in an open manner and import barriers complemented by supply-side measures, i.e. infrastructure improvements, micro financing, extension services, guaranteed competition on national markets etc.

The primary interest of the LDCs should be that the dumping of food from the industrialised nations onto the world market must cease. It should be emphasised that all support measures which increase production levels in the OECD countries tend to depress world market prices and ought to be reduced. Not simply export support and Amber Box support, but all forms of support that enable goods to be sold below the cost of production, i.e. also Blue Box and certain Green Box support measures should be abolished.

Secondly the LDCs should not be requested to make further liberalisation commitments. It is important for the LDCs to retain or enhance their rights to protect their own vulnerable markets with import protection measures (both tariffs and safeguards) – at least as long as industrialised nation dumping continues. Tariffs are often the only form of protection they can afford. The G33 proposals on SSM and SPS represent an opportunity to facilitate the introduction of safeguard measures in countries whose food security and rural livelihoods are threatened.

The question of increased market access is also important, primarily for the export sector. It should however be stressed that despite the existence of various non-tariff barriers, market access to OECD markets is already rather good for LDC exports. Only rice and sugar are presently confronting tariffs on the EU market, and chances are good that sooner or later tariffs will be reduced or abolished for most products on the US market as well (although the huge US trade deficit may strengthen US opposition to import liberalisation).

As industrialised countries are currently the biggest exporters, it should also be borne in mind that a general reduction in import barriers for major agricultural products such as grain and animal products may primarily benefit exports from the industrialised world.

The Marrakech Resolution on LDCs and Net Food-Importing Developing Countries is problematical because it lacks a clear analysis, division of responsibilities and implementation mechanism. It is important that decisions are implemented and compensation paid as promised by the industrialised countries. Compensation should be provided in the form of cash grants and development support and only in acute situations as food aid. At the same time it is important that the problems of the net importing countries are not used as a pretext to retain distorting support measures.

As regards ODA, finally, it is imperative to reverse the drastic decline that has been registered in assistance to rural development in general and agricultural production in particular. Exactly which activities that need international support must depend on the situation in each country, but agricultural research is one obvious area where needs are huge and largely unmet. Today, research on improved seeds and agricultural inputs has become completely dominated by the large transnational companies, with limited interest in small-scale agriculture in low-income countries, international public funding of such research has been dwindling. In order for Africa to emulate the “green revolution” of Asia, or at least increase smallholder productivity above its present miserable levels, both relevant research and an intensification of extension services are badly needed.

GATS (General Agreement on Trade in Services)

CHAPTER 11

11.1 The large and growing potential of trade in services

The production of services forms a growing proportion of GDP in both industrialised and developing countries. Services of various kinds currently account for two thirds or more of GDP in OECD countries (77 percent in the USA, 66 percent in EU15), and over 50 percent of GDP in most middle-income countries. The equivalent proportion in the very poorest nations is slightly over 40 percent of GDP.

It is estimated that services accounted for two thirds of total FDI in 2001–2002, valued at some BUSD 500 (UNCTAD, *World Investment Report 2004*, p. 15)

By its very nature, the service sector is extremely heterogeneous, and includes everything from shoe shiners, door-to-door hawkers and domestic servants to bishops, generals and IT millionaires. In most industrialised countries, the service sector consists of a majority of highly educated people, not least in the public sector, and average salaries are often higher than in the manufacturing industry. However, in developing nations, where the service sector is dominated by the urban informal sector, the situation is very much the opposite; as a rule service sectors in developing countries have an even higher proportion of the economically active population than of GDP, wages are generally low, and job security non-existent.

In recent decades, as a result of the expanding service sector in industrialised countries, the rate of growth of trade in services has outstripped the growth of trade in goods. All signs indicate that this trend will become even more pronounced in the future.

Another factor pointing towards a rapid growth in future international trade in services is the development within the area of communications that has been touched on earlier and which means that geographical distance is becoming less and less of a factor in many of the most dynamic service sectors. There is, however, a marked tendency towards "cluster building" in certain types of services; there are "financial centres", "IT clusters", "research clusters" and so on in the mature industrialised countries. There are similar embryonic geographically concentrated networks in certain developing countries too (e.g. an IT cluster in Bangalore, India, or call centres in the Caribbean and India).

It is difficult to obtain precise information on the volume of trade in services. In contrast to trade in products, services are not subject to import duties, and the in or outflow of services is not registered by any customs authorities. Balance of payments statistics offer certain pointers for certain types of services, but there are plenty of sources of error.

It is also difficult to estimate the extent of trade barriers within the service sector. As there are no duties, quotas or similar on services, the obstacles to trade are of a different nature to trade in general. As a rule, formal or informal barriers largely apply to the establishment of service companies abroad (which corresponds to the so called *Mode 3* in GATS – see below) or visa or immigration restrictions concerning the opportunities for individual service exporters to obtain entry permits and supply services (*Mode 4* in the GATS Agreement).

Trade in services is widely believed[24] to account for 20–25 per cent of total world trade. According to WTO estimates (see UNCTAD, *World Trade Report 2006,* p. 7), total exports of commercial services in 2005 reached BUSD 2,415, as against BUSD 10,120 for world merchandise exports.

The disadvantaged position of the LDCs in relation to the more developed nations is even more pronounced in services trading than in goods trading. The LDC share of world service exports is slightly lower than their share of goods exports – around 0.4 percent (UNCTAD, *Handbook of Statistics 2006*, Table 5.1) – and is dominated by services which, on average, are not skill-intensive.

Table 11.1: Estimate of world trade in services in 2004 millions of current USD

Exports in services, MUSD 2004	World total	LDC total	LDC/world (%)
Commercial services	2 179 500	9 000	0.41
– Transportation	505 600	1 800	0.36
– Consumer movement/travel	633 900	4 700	0.74
– Other commercial services	1 040 000	2 400	0.23

Source: WTO, web, May 2006

24 For further discussion about data and methodology, see for example Roberts (2000).

Tourism has, more than any other type, dominated the service export niches of LDCs to date. The tourist niche is reminiscent of raw materials exports in the sense that comparative advantages are related to natural assets – including attractive climate, beautiful sandy beaches and exotic environments – rather than access to skilled manpower.

In many developing nations outside the LDC group, service trade is increasing rapidly in other areas too. These include transport, construction and contracting (where countries like China and Thailand compete successfully with corporations from the industrialised world), call centres and reservation centres for airlines and credit card companies (where smaller islands in the Caribbean have enjoyed great success), certain consulting services, data processing, etc. Developing countries with a large pool of well-educated, English speaking professionals – e.g. India – have also exploited programming and other qualified development work niches within the IT sector. Thanks to its well-trained healthcare personnel, Cuba has successfully marketed healthcare services to Latin America and even parts of the industrialised world. As a general rule, however, the poorer a particular country is, the more likely it is that the country is a net importer of services.

The GATS agreement lists around 160 different types of services (see below). Naturally, it is impossible to specify which services the various LDCs should specialise in. However there is tremendous potential, and in a longer-term perspective, there are major opportunities for the LDCs to create new niches within the service sector.

11.2 The GATS agreement and its effects

11.2.1 GATS classification of trade in services

The *General Agreement on Trade in Services* (GATS) is the first multilateral agreement designed to create a regulatory framework for the cross border trade in services. GATS entered into force in January 1995 as a result of the Uruguay Round negotiations to provide for the extension of the multilateral trading system to services. The overall aim of GATS is to achieve the successive liberalisation of trade in services, and as stated in the Preamble, GATS is intended to contribute to trade expansion "under conditions of transparency and progressive liberalization and as a means of promoting the economic growth of all trading partners".

GATS is part of the "single undertaking", and all member states have committed themselves to entering into successive rounds of negotiations with a view to opening up more and more service sectors. The first round of negotiations began in January 2000.

The concept of services is not clearly defined but covers, in the GATS Agreement, "any service in any sector except services supplied in the exercise of governmental authority". GATS distinguishes between twelve different categories of services, which are in turn divided into around 160 sub-sectors.

Main categories of services in GATS:

- business services (including professional and computer services)
- communication services
- construction and related engineering services
- distribution services
- educational services
- environmental services
- financial services (including insurance and banking)
- health-related and social services
- tourism and travel-related services
- recreational, cultural and sporting services
- transport services
- other services not included elsewhere

As regards the modalities of trade in services, GATS further defines four different "Modes of Supply", depending on the territorial presence of the supplier and the customer at the time of the transaction. Naturally, many transactions may include more than one mode of supply. The four modes are services supplied

(1) from one member state into the territory of another member (cross-border trade)
(2) in the territory of one member to a customer from another member (e.g. nationals from one country have moved abroad as tourists, students, patients etc. to consume the service in question)
(3) by a service supplier of one country through the commercial presence in the territory of another member country (commercial presence abroad); and
(4) by a service supplier from one country through the presence of natural person(s) in the territory of another member (i.e. consultants or health workers supplying a service in another country).

In terms of value, WTO (see *World International Trade Statistics 2005, p. 8*) estimates the relative importance of the four modes as follows:

Table 11.2: Estimates of relative importance of trade flows in services by mode of supply

Mode 1: Cross-border supply	35%
Mode 2: Consumption abroad	10–15%
Mode 3: Commercial presence	50%
Mode 4: Presence of natural persons	1–2%

11.2.2 Basic principles in GATS

GATS is one of the agreements that resulted from the Uruguay Round of negotiations. However, as very little has occurred within the various sub sectors covered by GATS, the agreement still essentially addresses overall principles.[25] It is difficult to analyse the effects of agreements that still do not exist, and we will confine our comments to an account of certain basic principles that have been established, and to considering some of the questions raised by many developing countries.

It is also worth emphasising that the GATS Agreement is relatively vague and difficult to interpret as compared to corresponding WTO agreements on the product side. Trade in services is not about tariffs and quotas but about issues touching on other, more sensitive, areas such as the rights of foreign service companies in the host country. For instance, the right to a level playing field in public sector tender processes for the provision of services, or requirements that public utilities supplying water, energy, telecom, transport etc. that were previously regarded as natural monopolies should be opened up to competition.

To favour domestic service providers has traditionally been regarded as quite legitimate in most countries and, as a general rule, it could be said that trade in services is surrounded by more explicit or disguised protection than trade in goods, and that developing countries are more restrictive than OECD countries.

In contrast to conventional foreign trade, there are no established economic theories on the trade in services, which in certain important respects has its own special characteristics, and there has been relatively little research into the effects of its liberalisation in poor countries.

25 In two areas of special interest to the industrialised countries – telecommunications and financial services – more binding agreements have been reached. The LDCs played no active role in these negotiations.

Different types of measuring instruments are also required. These methodological and theoretical uncertainties are one example of difficulties – which are themselves fertile ground for strongly politicised standpoints – that permeate research even in industrialised countries into the effects of measures such as the privatisation of public utilities and the effects of privatisation and greater competition in health, education and other social services. It is no coincidence that GATS is far more controversial in the OECD countries than most other WTO agreements (with the obvious exception of agriculture).

It is therefore not surprising that a common criticism of the GATS agreement is that it was not preceded by any "impact assessments" on how its application would affect different countries and service sectors.

The principles on which GATS is based are, however, generally the same as for trade in goods: the Most Favoured Nation principle, and the principle of non-discrimination against foreign companies. Exceptions from the MFN principle are allowed for a maximum period of twelve years. Services for which the countries wish to maintain a monopoly for the public sector may be excluded, if a country so decides. As in GATT, member states also have the right to introduce restrictions that aim at protecting public morale or safety regulations protecting the life or health of humans, animals and plants.

Since tariffs, quotas or similar barriers to trade do not exist in trade in services, the GATS Agreement places a considerable emphasis on the reduction of more disguised forms of protectionism and on general principles related to transparency and openness. For example, all WTO members are obliged to notify WTO's Council for Trade in Services at least once a year concerning all legal or regulatory changes that significantly affect trade in all service sectors where liberalisation commitments have been made.

The market access provisions of GATS, laid down in Article XVI, cover various types of restrictions that are not permitted to remain. These restrictions include limits on the number of service suppliers or the value of operations, the number of operations carried out, the type of legal entity, the participation of foreign capital, and others. The GATS rules thus clearly limit the opportunities for host countries to regulate a large number of activities carried out by foreign service providers.

11.2.3 Developing country interests and positions

The exceptions for developing countries are more generous in GATS than in equivalent agreements on the goods side. Developing countries are permitted to open up fewer sectors, and to do this more slowly than industrialised countries, and liberalisation of trade in services must be carried out "with due concern for national goals and the level of development of individual members".

At the WTO Ministerial Meeting in Hong Kong in December 2005, LDCs were granted exemption from making any commitments related to liberalisation of services. However, the industrialised countries in their bilateral negotiations, and the EU in particular, are placing heavy pressure on developing countries, including LDCs, to open up their services sectors.

The GATS negotiations are of a different nature than other WTO negotiations as they are essentially of a bilateral or plurilateral character. The main method of negotiation is based on the so-called request-offer approach. A request normally consists of a letter from country A to country B, asking the latter country to include an additional sector in its liberalisation offer, or to remove existing limitations directed towards foreign service providers. The offers normally address the same issues as the requests, that is, it is an offer to add new sectors or to reduce the country's level of restrictiveness.

The participants in the services negotiations have been exchanging bilateral initial requests since June 2002. By March 2006, 69 countries – but very few LDCs – had submitted initial offers, and an additional 29 countries had submitted revised offers (information from WTO's website).

11.2.4 Profound consequences

One key difference between GATS and other WTO agreements is that GATS allows all countries to sign up according to the *smorgasbord principle,* sometimes known as a *bottom-up approach* or *positive listing.* In concrete terms, this means that countries can choose which sectors they wish to liberalise, and exempt certain areas e.g. financial services, energy supply or healthcare from the principle of equal treatment of domestic and foreign service suppliers. A country can also decide that a particular service sector, e.g. education, should be wholly reserved for the public sector.

In practice, however, the GATS Agreement is a hybrid between *bottom up* and *top down* approaches in that many of the most controversial issues – concerning subsidies, public sector tenders, national regulations etc. – are covered by *general rules.* Consequently, demands for equal treatment nationally, and the application of the Most Favoured Nation rule can be regarded as overriding principles that a country is unable to not select or to deselect.

However, as very few binding agreements have been signed to date, there is a certain amount of uncertainty surrounding the possibility of obtaining approval for the *smorgasbord principle* from the other countries. If a country opens up a certain sector to domestic, privately operated companies, the country can – unless it has sought an explicit exemption when it signed up – probably be forced to open this sector to foreign competition in accordance with the equal treatment rule; this is just one of the concerns raised by developing nations and various NGOs.

Other controversial issues that have attracted criticism from developing countries and NGOs are the restrictions that the GATS agreement prescribes concerning the host country's room to manoeuvre when stipulating rules and regulations for foreign service companies wishing to establish themselves; GATS is similar in this respect to TRIMS (see Chapter 8.5). Accordingly, host countries are not permitted to stipulate joint ventures when foreign companies are investing, nor demand that a certain proportion of jobs there must be filled by local people (e.g. at tourist attractions), unless this is stated at the very beginning. With regard to environmental issues, a number of questions have been raised concerning what the parts of the GATS agreement covering tourism may mean; the general paragraphs on a ban on limiting the number of service operations may, for example, impair the host country's right to restrict mass tourism in environmentally sensitive areas. In all the above named cases it is, however, possible for the country to specify the limitations to apply in its binding list before an agreement has been reached.

The fact that GATS also includes rules for setting up service companies in other countries means that it includes elements that touch upon multilateral investment rules, and concerns have been expressed from various directions that GATS is attempting to sneak a multilateral investment agreement (similar to the failed Multilateral Agreement on Investment, MAI) in through the back door.

From the developing countries' side, severe criticism has been levelled against the lack of symmetry concerning freedom of movement for people: all borders are normally open to citizens of industrialised countries, but not to people from developing countries. Naturally this is also a problem within goods trading but freedom of movement is often absolutely crucial for trade in services. The paragraphs in GATS that address these issues appear in Mode 4, which covers the rights of individuals to supply services in other countries.

A common developing country position has been to urge for improved opportunities to utilise Mode 4 in order to gain market access in the OECD countries. The LDCs, in particular, have asked for more flexible criteria as regards the level of education and expertise that the developed countries demand before a service provider from a low-income country is allowed to enter. The LDC position is that also semi-skilled workers – e.g. in construction or tourism – should be allowed to use Mode 4.

How these issues concerning the free movement of people are to be resolved is far from clear – what is absolutely clear, however, is that developing country demands for greater freedom of movement under Mode 4 of the GATS Agreement clash with the industrialised countries' strict rules for granting entry visas and temporary residence and work permits for people from developing countries.[26] There is an acute lack of coherence between the WTO's overall goal of opening up borders to goods, services and people and the ever-tougher entry restrictions imposed by USA, EU and Japan. How can an individual be expected to visit clients and supply services if he/she is not even permitted to enter the country?

The developed country response has been that migration issues are dealt with by authorities other than those dealing with WTO and foreign trade.

It is also worth noting that this is not only a complicated issue between industrialised and developing countries; many developing nations also impose entry restrictions which limit the freedom of movement for service suppliers, not least from poor countries.

It is clear from this resume of the GATS agreement that there are major grey areas concerning how the agreement should be interpreted, and how quickly specific negotiations within the different sub sectors can be initiated.

The LDCs' role has mainly been that of passive observers as far as GATS is concerned. In recent years the EU in particular has, however, been putting much pressure on developing countries, including LDCs, to present their offers and when the offers have been presented, the EU and other OECD countries have often urged the countries to go further and to open up more sectors and subsectors.

Neither individual LDCs nor the LDCs as a group have set out or defined their interests very clearly, and there has been no joint initiative from them.[27] The modest service exports of the LDCs and their enormous disadvantages compared to service companies owned by industrialised country interests will probably remain important factors in their lack of involvement in the trade in services. They have chosen to save their meagre negotiating resources for other WTO issues, and the promise of "posi-

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[26] Under for example the EU Schengen Agreement, it often takes up to four weeks for a visa application from an African country to be approved – if it is granted at all.

[27] As spokescountry for the African members of WTO, Mauritius has formulated demands that can be assumed to be in line with LDC wishes. These requirements firmly stress the importance of recognising *"the priority of development objectives"* and "*the primacy of national policy objectives, laws and regulations*". Special reference was made to the importance of considering the interests of LDCs. Specific wishes also included a demand that developing countries should be allowed to adopt "*emergency safeguard measures*", something that the industrialised countries have been unwilling to accept.

tive listing" has also created the impression that there is no urgency in the GATS field. In the summer of 2003, however, certain guidelines for LDCs were adopted in principle and a growing interest on the part of the LDCs in trade in services was expressed. The guidelines indicate an increased desire for improved export opportunities for the LDCs and, at the same time, demand low levels of requirements for liberalisation of their services sectors (see National Board of Trade, 2004, p. 199).

Even so, it is important that the LDCs look after their own interests in the area of services trade as well as strengthening their research and negotiating capacity. Given the wide range of areas covered – including very sensitive sectors such as water, health and education – GATS may eventually prove to have far more wide-ranging consequences than tariff cuts and liberalisation within trade in goods.

The TRIPS Agreement on Intellectual Property Rights

CHAPTER 12

The TRIPS (Trade-related Aspects of Intellectual Property Rights) agreement covers several different types of intellectual property rights including patents, copyright, trademark protection and protection of business confidentiality, industrial design, integrated circuits and geographical indications (e.g. "Champagne" or "Roquefort cheese").

12.1 Intellectual Property Rights

Certain forms of intellectual property rights such as trademark protection are designed to guarantee fair competition, and an author's copyright may be considered as a moral right. Patents, the most powerful form of intellectual property rights, give the holder a monopoly on all but strictly private use of patented products or technologies for a limited period of time.

The rationale for patents is to give individuals or companies who develop new products and technologies exclusive rights to the financial benefit from their investment and development costs. This protection aims to resolve the free rider problem and stimulate technical development. The social benefits of patents, in the form of providing incentives to technical developments must, however, be weighed against the cost of higher consumer prices caused by this monopoly. As we move from an industrial society to a "knowledge-based economy", intellectual property rights will become increasingly important.

The main sources of incomes related to intellectual property rights are license fees for patents and royalties, which have increased appreciably faster than global trade in general in recent years. Over the period 1995–2004, such payments have accounted for five to six percent of the value of world commercial services.[28] The United States and other developed countries account for lion's share in terms of both receipts and payments, however the dominant position of the US has decreased as the EU and Japan have expanded their income from this source faster than the US. Among developing countries, Singapore, China and South Korea have increased their payments for, and income from, royalties and license fees sharply in recent years.

Royalty and license fee payments by developing countries outside East Asia account for less than four per cent of global payments (in 2004). The LDCs play a marginal role in this context, and their receipts from intellectual property rights are insignificant.

Understandably perhaps, intellectual property rights have been developed in countries that have made the greatest strides in developing advanced technology. Not for nothing did today's industrialised countries introduce intellectual property rights when they had already started developing their own technology. Before its introduction, everyone copied foreign technology as a matter of course. An overwhelming majority of all patents are held by companies from industrialised countries.

Intellectual property rights are mainly national, and the rules covering what may be patented, for example, and on what conditions vary widely from country to country and also reflect a country's stage of development. Patent protection is generally stronger in more developed countries.

There is a long history of harmonising intellectual property rights[29] which has made it possible, for example, to apply for patents in several different countries simultaneously. However the TRIPS agreement was the first to create an international standard regulating in what fields of technology patents must be granted (all areas excluding exceptions stated), how long the patent should last and how powerful the rights must be. Another crucial difference is that all previous agreements on intellectual property rights had been separate agreements, while TRIPS is a mandatory part of WTO membership and is linked to the WTO's dispute settlement system and Trade Policy Review Mechanism.

12.2 The TRIPS Agreement demands a global minimum standard

When the TRIPS agreement was adopted as part of the Uruguay Round it was the first time a global minimum standard for the protection of in-

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28 Figures in this paragraph are taken from UNCTAD, *World Trade Report 2006*.

29 Principally through the Berne and Paris conventions and WIPO, the UN *World Intellectual Property Organization*.

tellectual property rights had been agreed. The agreement incorporates some of the existing international conventions that are administered by the World Intellectual Property Organisation (WIPO). These include, amongst other, the Berne Convention for the protection of copyrights of literary and artistic work and the Paris Convention on the protection of industrial property (patents, industrial designs, etc.).

As in other GATT/WTO agreements, TRIPS is ruled by the principles of national treatment, i.e. non-discrimination of foreigners, and most-favoured-nation in other words equal treatment for nationals of all trading partner members of the WTO. TRIPS even goes one step further in the sense that the Agreement does not permit any exceptions from the MFN principle for regional agreements signed since 1995 (such exceptions are otherwise common in bilateral or regional free trade agreements).

The minimum standards established by TRIPS are higher than those required by previous international conventions and are more or less equivalent to existing intellectual property rights protection in industrialised countries. In many respects the agreement eliminates all national flexibility in terms of, for example, the scope of the patentable area. In other respects the TRIPS agreement is somewhat unclear, and it remains to be seen how much scope there is to deviate from the standard established by the industrialised countries and establish systems that are more in line with the specific needs and circumstances of other countries.

The TRIPS Agreement covers five broad areas:

- How the basic principles of the trading system and other international intellectual property agreements should be applied;
- How to set minimum standards for the protection of intellectual property rights;
- How to set minimum standards for the enforcement of those rights;
- How disputes on intellectual property between members of the WTO should be settled, and
- Special transitional arrangements during the period when the new system is under implementation.

The standards set are quite high, but TRIPS accepts considerable flexibility as to how the legislation is to be designed in each particular country.

While legislation is comparatively cheap to introduce, and is a one-off budgetary cost, full implementation of the TRIPS agreement entails considerable costs as regards observance and enforcement. Many countries, not least among the group of successful East Asian countries, are currently making considerable efforts to prevent local companies from producing and exporting pirate copies of branded Western goods. For the LDCs, with limited budgetary resources, the financial burden of TRIPS may turn out to be substantial.

Even higher costs can be expected for developing countries which are net importers of technology in the form of payments to the richer countries which export patented technology. In a study made by the World Bank in 2002 (referred to in Swedish National Board of Trade, 2004, p. 224), it was estimated that financial flows from poorer to richer countries would be very high. The largest net winners were identified as the USA, followed by Germany and Japan. The largest losers were South Korea, Greece, China and Spain. Although no LDCs were included in the study, it is quite clear that all LDCs belong to the category of net buyers of patents and other forms of intellectual property. Without denying the need for international protection of intellectual property rights it can be concluded that the global reinforcement of intellectual property rights through the TRIPS Agreement mainly benefits the richest countries, at the expense of low and middle income countries which need to import patent-protected technology.

Despite its name, the TRIPS agreement covers a great deal more than directly trade-related intellectual property rights issues. The agreement has created much controversy, not least in the areas of patents on living organisms and on pharmaceuticals.

12.3 Patents on living organisms and genetic material

Patents on living organisms and genetic material have been permitted in the Western world for over ten years and have contributed greatly to rapid developments within biotechnology. At the same time the preconditions for research have been fundamentally altered. Research in biotechnology and genetic engineering is now primarily the domain of private companies, and even the findings of government-funded research are often patented.

According to Article 27.3b, countries can exempt patents on plants and animals and “essentially biological processes”, but not on microorganisms or “microbiological processes”. As cell cultivation from plants and animals in the majority of countries is defined as microorganisms for patent purposes, this exception is a significant grey area. For developing countries that have not granted patents on any life forms, the agreement is a significant move away from previous legislation and also from widespread popular opinion on what is morally acceptable.

There are other fears that a further strengthening of intellectual property rights protection on gene technology research would lead to increased *biopiracy*. Biopiracy is the term for when a company patents living organisms or genetic material without acknowledging or compensating the original owner of the original material or recognising the contribution of the traditional know-how that was decisive in the development of the product. Biopiracy arises mainly due to shortcomings in national patent legislation, for example US patent authorities only need to take into account published information when investigating "prior art" outside the USA, while within the USA, oral sources must also be considered. As such, the TRIPS Agreement is not a direct cause of biopiracy but neither does it help prevent such patent abuse (Byström and Einarsson, 2000).

By strengthening the position of patent holders in several ways, TRIPS affects the distribution of economic resources between patent holders and the rest of society. This is the cause of one of several potential conflicts with the Convention on Biodiversity which seeks to ensure that the benefits of genetic resources are shared in a fair and equitable manner.

Article 27.3b prescribes that some form of plant variety protection be introduced in all member countries, something that currently exists in only a handful of developing countries. The present system for plant breeders' rights in the industrialised world is developed and coordinated by UPOV (Union for the Protection of New Varieties of Plants). If, for example, small farmers in developing countries stop using traditional seeds, which they are fully entitled to save from year to year and to further develop themselves, and switch to commercial seeds instead, plant breeders' rights may dramatically alter their entire situation. At present it is unclear how much leeway the TRIPS agreement gives countries to introduce plant variety protection that differs from UPOV and that is adapted to the conditions prevailing in developing countries.

The controversial Article 27.3b is currently under review. The African group has been very active in this respect and has put forward a number of far-reaching proposals. LDC demands include:

- it should be clearly stated that naturally occurring animals and plants, and parts thereof, may not be patented,
- patents must not be granted without proof that the country of origin of the biological material has consented (so called prior informed consent which is stipulated in the Convention on Biological Diversity as the terms and conditions for access to genetic resources. The same conven-

tion also established that genetic resources are owned by the country of origin),

- the flexibility to develop plant variety protection systems adapted to the needs of their own country must be maintained (GRAIN 2000).

12.4 Pharmaceuticals

According to the TRIPS Agreement, countries must offer patent protection to pharmaceutical drugs, something that is lacking in around 50 developing countries (Correa, 2000) and which was introduced by Sweden, for example, as recently as the 1970s. The TRIPS Agreement may result in sorely needed drugs becoming so expensive that they will be out of reach of many developing countries.

The Agreement provides certain leeway for compulsory licensing. Compulsory licensing is one way of preventing a patent holder from blocking the use of a patent, and can even be invoked to guarantee that it is possible to use a particular innovation in local production. In principle, TRIPS does not restrict the national right to determine the purposes for which a compulsory license may be sought. However, a series of detailed procedural requirements must be completed before a compulsory license can be granted.

The Agreement does not restrict the right to parallel imports. This is defined as a country importing a patented product against the wishes of the patent holder from a third country where it is sold more cheaply. For example, AIDS drugs are cheaper in India and Brazil than in many other countries, which is why other developing countries in particular have powerful reasons for wanting to be able to import medicines from such countries.

The issue of generic drugs and the right to parallel imports of medicines has continued to be a controversial topic. A special declaration at the WTO Ministerial Meeting in Doha in 2001 which stated that compulsory licences and parallel imports were permitted in the case of a national health emergency was widely interpreted as a victory for developing countries and recognition of their need to gain access to less expensive medicines. The Doha Ministerial Meeting also decided that the transitional period for LDCs to implement all provisions of the TRIPS Agreement on patent protection for medicines was to be extended to January 2016.

In August 2003, an agreement confirmed that developing countries may sell generic drugs cheaply not only in their own countries but also in other developing countries who are facing a “public health emergency” – which is clearly the case in many LDCs where the HIV/AIDS pandemic is causing huge human and economic costs – and lack the capacity to produce the drugs themselves. While this declaration is potentially very important, it should be observed that the majority of drugs on the WHO's Essential Drugs List are already out of patent, and therefore not affected by TRIPS.

12.5 LDC interests

Generally speaking, LDCs have the same obligations as other countries, but have been given more time to implement the agreement. Initially, the LDCs were not obliged to adapt their legislation to the TRIPS requirements until January 2006. This date has subsequently been extended to January 2013 (2016 for pharmaceuticals).

So far, the pressure on LDCs to fulfil all their TRIPS requirements has been limited. It is also very likely that the transitional period may be extended further, and that exemptions from the TRIPS Agreement such as access to parallel imports of inexpensive pharmaceuticals will continue to be granted. International public opinion would, for example, hardly tolerate that drugs to combat the AIDS pandemic, which is having disastrous human and economic effects on a number of LDCs, would be out of reach for the poorest countries in the world.

From an LDC perspective the TRIPS Agreement contains, however, a number of critical aspects. The Agreement was introduced in the face of strong opposition from developing countries, and would most probably not have been accepted if it had not been included in the Uruguay Round package, in which the developing countries felt they would benefit from the agreements on textiles and agriculture.

The Agreement is extremely unbalanced in the sense that the benefits mostly accrue to the industrialised countries, while a large part of the costs is borne by the developing nations. The industrialised countries need only make marginal amendments to their legislation while developing countries are forced to make major changes. Many LDCs will have to introduce totally new legislation. The administrative costs alone are high, and will also require access to highly qualified technical and legal expertise (for a financial cost estimate, see Finger and Schuler, 1999). Commitments by developed countries to provide technical and financial assistance for the implementation of TRIPS, and to create incentives for private companies and institutions to transfer appropriate knowledge to developing countries, have by and large failed to materialise.

Industrialised countries earn substantial amounts when their companies receive higher royalty payments and lose less to cheap pirate copies thanks to more powerful intellectual property rights. Theoretically, tougher intellectual property rights should result in more foreign investment and technology advances in the developing world which may help economic development in the long term. The link between intellectual property rights and foreign investments is not absolutely clear-cut however, and intellectual property rights are probably not the most important factor. In the short term at least, the TRIPS agreement will principally result in developing countries being forced to pay more to gain access to advanced technologies and products from the industrialised world.

As such it can hardly be claimed that the TRIPS agreement promotes the interests of LDCs. Conditions in the LDCs were not taken into consideration during the negotiating process, and the countries themselves still have only a very limited understanding of the agreement and its consequences. LDCs face high costs but gain very few advantages from implementing the agreement. The dynamic effects of introducing intellectual property rights protection offer very dubious benefits to LDCs and will only be realised in the long-term.

Most LDC countries failed to meet the terms of the Agreement by 1 January 2006 as the Agreement required. The relatively long implementation period is of no real significance for countries that – in the words of a WTO official – will probably only be ready for this type of intellectual property rights legislation in 50 years time. Advanced legislation in this area is not a plausible priority within their current development efforts.

The Lomé Conventions, the Cotonou Agreement and the Economic Partnership Agreements (EPAs)

CHAPTER 13

For the developing countries in general, and LDCs in particular, it is not the general tariff agreements previously in GATT and now in WTO that determine market access conditions to industrialised markets for their products. Since the 1970s, all industrialised countries have introduced specific general and unilateral tariff preference systems, GSPs, for products from the developing world. Even more advantageous import regimes have come into force for the LDCs. GSPs are based on the specific and sovereign decisions of each industrialised country or the EU, and are therefore unilateral in character. Each industrialised country, like the EU, is entitled to make decisions concerning changes in their own GSPs.

The EU, however has a more complicated trade policy structure, vis-à-vis both developing countries and LDCs, than other OECD countries. In addition to its system of general tariff preferences and an even more advantageous duty-free and quota-free preference structure for the LDCs, the EU has other preference arrangements based on various bilateral or regional agreements. These agreements partially overlap with its common preferences for developing countries within the GSP or the enlargement of its GSP for LDCs.

The EU's most important regional arrangement is with the ACP countries – the former colonies of individual EU countries in Africa, the Caribbean and the Pacific Region. From 1975 till 2000, trade preferences and economic cooperation between the EC/EU and the ACP countries were regulated by the Lomé Conventions (i–iv). In June 2000 a new agreement was signed in Cotonou between the EU and the ACP countries. It was headed "Partnership Agreement between members of a group of states in Africa, the Caribbean and the Pacific Region on one side and the European Community and its member states on the other", better known as the Cotonou Agreement.

Future relations between the EU and the ACP countries are expected to be largely determined by the EPAs, Economic Partnership Agreements, which are currently under negotiation between the EU and regional groupings of ACP countries (see Section 13.5 below). The future of the controversial EPAs is uncertain, however.

The EU has also other bilateral agreements stating unilateral trading preference which are still in force with certain Arab states in the Mediterranean region. These agreements are, one after another, being replaced by bilateral mutual free trade arrangements, and such mutual free trade agreements are already in force with Morocco, Algeria, Tunisia and Jordan Israel. The EU and Israel also have a mutual free trade agreement. Interim free trade agreements have been in force with PLO/PA in Palestine and with Lebanon since 1997 and 2003, respectively.

In addition to the arrangements outlined above, it is also worth mentioning that the countries in the Andean Pact receive positive special treatment from the EU thanks to a significant broadening of GSP benefits which places these Latin American countries on a par with ACP countries as regards access to the EU market. The Andean Pact is an economic cooperation organisation founded in 1969 for the countries surrounding the Andes with the exception of Chile who left the group in 1977. In 2006, Venezuela also left the Andean Pact, and decided to join the Mercosur instead (for further information about south-south free trade agreements, see Chapter 14). Central American countries also enjoy the equivalent special and differential treatment based on an enlargement of the GSP framework.

After long-drawn-out negotiations within the Union, a decision has been taken by the EU to grant duty-free market access to all LDC products with the exception of arms; the EBA initiative discussed earlier. From 5 March 2001, all tariffs were eliminated for all LDC products – with the exception of sugar, bananas and rice for which final tariff cancellation took place in 2006 (bananas) and will take place in 2009 (rice and sugar).

As so many LDCs had previously signed the Lomé Conventions and have now signed the Cotonou Agreement, it is worth providing a more detailed description of both these agreements, particularly in those areas that address the terms and conditions of trade preferences and the future.

13.1 The Lomé Conventions

The ACP group of countries has grown over the years from 46 states in 1975 when Lomé I came into force, to 71 states when Lomé IV expired. In connection with the signing of the Cotonou Agreement, the circle of ACP countries was expanded by a further six island states in the Pacific and so reached 77 member states. One of these states South Africa is, however, not eligible for preferential treatment or financing from the *European Development Funds,* EDFS, but is permitted to participate in project procurement linked to specific EU development assistance to other ACP countries. 33 of the 48 African ACP nations are LDCS, while only one nation, Haiti, has LDC status among the 15 Caribbean ACP members. Five of the 14 Pacific ACP states are LDCS which, if we add the most recent member, Timor Leste, adds up to 40 LDCS in the entire ACP group. Consequently the majority of LDCS are members of the ACP circle with only 10 outside this group.

The granting of non-reciprocal, preferential access to the EU market had been present in a series of agreements between the EEC/EU dating back to 1975, and was further reiterated and extended in the subsequent agreements. In addition to far-reaching beneficial trading terms, the Lomé Conventions also included specific instruments for levelling out export revenues within the agricultural sector, STABEX, and for development projects within the mining sector, SYSMIN. The EU also made a series of commitments in support of trade and investment. These instruments and other measures along with other EU development assistance to the ACP group were to be financed from special European Development Funds (EDFS).

An important element in the Lomé Conventions was the opportunity for origin cumulation within the EU-ACP group, i.e. the possibility to use inputs and semi-processed products from any other ACP country without losing the relevant tariff preferences. Cumulation of origin makes it easier to satisfy the criteria of original content for duty-free market access of certain ACP products to the EU market. It was also meant to encourage industrial co-operation and integration within the ACP group. In practice this opportunity has not been utilised to any appreciable degree due to lack of suitable industrial products and projects. The level of industrialisation in most ACP countries has been too low to benefit from this form of cooperation.

The Lomé Convention had to be revised when Lomé IV expired in 2000 as it had been granted a temporary waiver in GATT in 1994. This waiver had allowed the current convention to continue but not to be prolonged. One of the reasons for the decision was that the Lomé Convention was a unilateral free trade arrangement, which did not fulfil the requirements for mutuality as laid down in Article XXIV in GATT on free trade. The Lomé Convention also included a discriminatory preferences system vis-à-vis other developing countries outside the convention, which were forced to use the EU's GSP instead. As the Lomé Convention provided more preferential treatment for the ACP countries than for most other developing countries, this contradicted one of the fundamental principles of GATT and the WTO.

13.2 The Cotonou Agreement

On 23 June 2000, a new partnership agreement was signed between the EU and its member states, and the member states of the ACP group. The agreement covers a twenty-year period and will replace the current cooperation regime, except for the trade areas in which new agreements are to be negotiated and finalised before 2008.

Other important changes that should be noted are that both STABEX and SYSMIN have been eliminated from the Cotonou Agreement. Furthermore, the section on Trade and Economic Cooperation in the new agreement expressly states that the ACP countries must actively participate in the WTO and its multilateral trade negotiations. Regional economic cooperation and trade are also emphasised as key instruments for the integration of the ACP countries into world trade. In the area of trade, the only promise is that the committee of trade ministers are to "investigate what significance more extensive liberalisation could have for ACP country trade and economic development" (Article 34:2 in the Cotonou Agreement).

All-important sub sections within WTO regulations are covered by the Cotonou Agreement, and ACP countries' obligations to WTO are also emphasised. This enables the EU to put more pressure on the ACP countries to meet their WTO obligations as this can be carried out both within the WTO and within the framework of the Cotonou Agreement (articles 34–52). This should be noted against the background of the major economic, legal and administrative problems connected to the introduction of WTO regulations in ACP countries.

The Agreement also promised support from the EU to ACP countries for debt relief and for continued assistance in the implementation of comprehensive structural adjustment programmes. (Articles 66 and 67).

Full origin cumulation is permitted between and within the EU-ACP and the OCT territories[30] (i.e. remaining EU colonies). This may also cover primary materials from a neighbouring state that is not an ACP country, but to do so the ACP country concerned must seek approval from the EU. With regard to origin cumulation with South Africa, this should be done gradually. In the textiles area, however, rules are not as liberal. An annex to the Cotonou Agreement includes the specific and complicated rules of origin that the EU has set out for duty-free import of textiles from ACP countries.

On the whole, it should be stressed that important steps have been taken to make various forms of cumulation easier both within the ACP

30 OCT territories include Greenland, New Caledonia, French Polynesia, Dutch Antilles, Anguilla and the Falkland Islands.

group and with South Africa and where applicable, other neighbouring non ACP countries.

It is also worth noting that there is a specific article on fishing in the Cotonou Agreement. According to this, the parties have expressed a willingness to negotiate new fishing agreements. However, this exclusively concerns the right of EU members to fish in ACP territorial waters and not vice versa (Article 53).

13.3 The effects of tariff preferences

ACP group exports to the EC/EU rose by just four percent by volume during the period 1988–1997, while exports of other developing nations to the EC/EU increased by 75 per cent during the same period. ACP countries' market share of the EU market has fallen from over seven percent in 1976, when the first Lomé Convention came into force, to just 2.8 percent in 1999, when the fourth Lomé Convention expired, and to approximately three percent in recent years.

In addition to all the other handicaps experienced by African nations vis-à-vis more advanced developing nations, it is also worth noting that the true difference between the level of preferences enjoyed by these more advanced nations within the framework of the EU's general system of tariff preferences (GSP) and the ACP countries is just two (2) percent. An ACP country tariff level advantage of a mere two percent does not play a decisive role in enhancing the competitiveness of these countries' products.

However, one third of ACP exports enjoy a preference level of more than three percent above the GSP preference level and these exports increased 62 percent by volume during the period 1988–97, which could indicate that a higher preference level may be of major significance.

The "preference erosion" caused by successive rounds of general tariff reductions implies that ACP countries are now down to a preference level for manufactured goods that is 1.6 percent above the GSP level, i.e. only a very marginal advantage. The sectors that enjoy the most significant preferences are chemical products, shoes and textiles plus clothing. However the rules of origin limit the opportunities for most ACP countries to take advantage of these benefits.

The level of preferences on agricultural products has remained high, although 50 percent of agricultural exports, including coffee and cacao, have ceased to enjoy preferential treatment since 2000. Other agricultural exports still enjoy a preference level of around 10 percent.

Around 1,000 agricultural products are still not totally duty-free for ACP countries not belonging to the LDC group. For many agricultural products there is either a certain tariff reduction or a reduction in Euros per ton, or seasonal restrictions. The competitiveness of ACP countries could be considerably improved if these tariffs and restrictions were removed.

13.4 A note on EU fishing agreements

Concerning the EU's fishing agreements with developing countries the major, repeated criticism is overfishing or depletion of fish stocks off the coast of Africa. Over the years the issue of overfishing has been a constantly recurring theme in reports from the UN Food and Agriculture Organisation, FAO.

The background to this discussion is that the EU fishing fleet is vastly oversized in relationship to the fish stocks in the union's own waters and fishing opportunities in international waters. The industry is also heavily subsidised within the EU. At the same time, a large number of developing countries and not least LDCs possess rich fishing grounds within their territorial borders while their own low technology fishing fleets could only manage coastal fishing.

The European Commission has mostly managed to negotiate very advantageous agreements on behalf of the fishing fleets of its member states. However, there has been very little control of either fishing methods or catch volumes, which has resulted in overfishing. This has in turn resulted in the steady depletion of coastal fish. Fish stocks have fallen dramatically including in the African ACP countries which have concluded bilateral fishery agreements with EU. Even though the EU has helped to improve technology, training and equipment through its aid programmes to the developing states in question, the final result has been a depletion of fish stocks and consequently supplies for use by local people have dwindled.

With regard to the EU's future rights to continue fishing in ACP territorial waters, this is covered by the Cotonou Agreement in which the ACP countries and the EU and its members also undertake to enter into similar agreements in the future. It should be noted that the fishing agreements in themselves are negotiated between the European Commission and each country and therefore constitute separate, bilateral agreements.

The Cotonou Agreement provides for the duty-free market access of processed fish products, and during the period 1987 to 1997 the ACP countries' exports of such products to the EU increased by 110 per cent. While this may appear to be a very positive development, it reflects just a small fraction of the ACP countries' potential fish exports.

In this context it is worth noting that the tariff level for fish and fish products is high, which means that the preference margin for the ACP countries is correspondingly high.

For all the LDCs possessing fishing waters, the introduction of zero tariffs for fish and fish products is extremely positive. At the same time the overfishing problem, especially in large areas along the African coast, must be dealt with if the countries concerned – of which several are LDCs – are to be able to utilise and develop any domestic fishing industry worth mentioning.

13.5 The Economic Partnership Agreements (EPAs)

Negotiations on EPAs are mandated within the framework of the Cotonou Agreement and will, if they can be successfully concluded, form the basis of future EU-ACP economic relations. For the majority of LDCs which are also members of the ACP group, the results of the EPA negotiations are likely to have a greater economic impact than what can be expected from multilateral agreements, even if the current WTO impasse can be overcome.

Under the Cotonou Agreement, the ACP countries' trade preferences will be extended to the end of 2007. According to the European Commission, the unilateral Lomé preferences enjoyed by the ACP countries are in breach of fundamental GATT/WTO principles, in particular the Most-Favoured Nation principle, and the EU argues that WTO-compatible rules must replace the current unilateral preferences.[31]

The EPAs are in essence reciprocal free trade agreements that the EU negotiates on a bilateral basis with six major ACP regions, including LDCs as well as non-LDCs.[32] The issue of reciprocity is a major change from the preferential system that characterised the previous Lomé Conventions.

EPA negotiations began in 2002, but at a slower pace than originally envisaged, and should – according to the original and probably not very realistic time-table – be concluded no later than early 2008.

In the view of the European Commission, the main areas that should be covered by the EPAs are:

- reciprocal trade liberalisation in ACP countries with each partner country granting duty-free access to as much as 90

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31 The Lomé and Cotonou Agreements are judged to be inconsistent with the WTO's "enabling clause", under which developed countries are permitted to give non-reciprocal preferential treatment to just two categories of countries: either all developing countries, or all LDCs. As the ACP regions cover countries of both groups, the original preferences granted to the ACP countries are incompatible with current WTO rules.

32 In June 2002, the Council of the European Union emphatically stated: "It has sometimes been understood that the principle of differentiation implies that reciprocity would not be required from LDCs participating in an EPA. Reciprocity is one of the basic elements of EPAs from which no partners wishing to participate can be excepted without depriving EPAs of their essence." (quoted in EcoNews Africa, *EPAs through the Lens of Kenya*, Nairobi, September 2005).

percent of imports from the EU during an implementation period of 10–12 years;

- the establishment of essentially free trade areas negotiated between the EU and ACP countries grouped together in six different blocs or regions;
- substantial liberalisation of trade in services;
- the acceptance on the part of the ACP countries of including regulations concerning liberalisation of investment, public procurement and competition policy, i.e. three of the four "Singapore issues" rejected by the ACP countries at successive WTO meetings.[33]

In addition, the EPAs are envisaged to cover a number of other areas of economic cooperation. Despite numerous requests from the ACP countries to include development aid as part of the EPA negotiations, the European Commission has so far refused such an approach as development cooperation is negotiated and covered in other agreements.

It is still too early to assess the outcome of any of the EPA negotiations, which are proceeding at a rather slow pace. One reason is that the EU proposal to replace the Lomé/Cotonou preferences with reciprocal trade liberalisation has, from the very beginning of the EPA discussions, met considerable resistance from the ACP countries. The ACP countries want to put development at the top of the agenda, while the EU gives first priority to trade liberalisation. There is widespread concern within the ACP group that duty-free imports from the EU would undermine key sectors of their domestic economies, in addition to leading to significant revenue losses.

As early as November 1997, the ACP Heads of State called, in a joint declaration, on the EU to

- *maintain non-reciprocal trade preferences and market access in a successor agreement;*
- *maintain the preferential commodity protocols and arrangements; and*
- *liberalise and improve the existing rules of origin so as to foster the expansion and diversification of ACP exports." (from the Libreville Declaration by ACP Heads of States, November 1997).*

Subsequent declarations have underscored these and other ACP country concerns. A few excerpts from a joint statement from the African Union's

33 The fourth "Singapore issue" is trade facilitation, which is far less controversial than the other three.

Ministers of Trade, dated April 2006, may illustrate their widespread dissatisfaction with the proposed EPAS:

- *We reiterate that economic partnership agreements with the European Union should be tools for the economic development of Africa. We express our profound disappointment at the stance taken by negotiators of the European Commission in so far as it does not adequately address the development concerns that must be the basis of relations with Africa. We urge our negotiating partners to clearly demonstrate the development content of the proposed agreements, and adequately address supply side constraints, infrastructure bottlenecks, and adjustment costs, bearing in mind that trade liberalisation together with the accompanying liberal policies may not by itself deliver economic development. In this regard, we emphasise that the development content should include, inter alia, adequate financial and technical resources; full market access to the EU market and policy space and flexibility for implementation of development programmes in Africa….*
- *We further note that market access openings have been significantly undermined by health, sanitary and phytosanitary, technical and market standards maintained by the EU partners.….We note that many of the EU standards go beyond what would legitimately be appropriate…*
- *(on the issues of investment policy, competition policy and government procurement) we reiterate the concerns we have raised at the World Trade Organisation, leading to their being removed from the Doha Work Programme. We reaffirm that these issues be kept outside the ambit of Economic Partnership Agreements. (Nairobi Ministerial Declaration on Economic Partnership Agreements,* African Union Conference of Ministers of Trade, 12–14 April 2006, Nairobi, Kenya).

Similar concerns have also been expressed by the European Parliament among others (see their resolution on EPAS dated 23 March 2006) and by a large number of ACP governments, academics and NGOS.

Other important areas of contention are the dispute settlement mechanism – where the ACP countries want an arrangement similar to WTO's, while the EU insists on following its own procedures – and, of course, agriculture, an area of obvious concern to developing countries but where the EU has been very reluctant to make any commitments beyond the very limited promises made within the WTO framework.

Another complication is the question of compatibility between the EPAS and the various regional agreements on trade and economic integration that have been formed in recent years, not least in Africa (see Chapter 14). The four regions in Africa which are negotiating with the EU at present[34] are not identical with the regional blocs that already exist-such as ECOWAS, SADC, COMESA and others – and while the EU argues that the EPAs should support economic integration in the ACP countries, the countries themselves would prefer regional integration carried out at a pace desired by the countries themselves. By expecting each region, whose individual countries often belong to different trading blocs, to open up to Europe by a particular date the EU may undermine a sensitive and important political and economic process in the ACP countries concerned.

13.6 Conclusions

The Lomé and Cotonou Agreements contained many positive aspects for the developing countries in the ACP group. Trade preferences were more generous than the GSP system, although the overall lowering of tariff barriers also signified substantial preference erosion over the years. Today, the majority of ACP countries which are also LDCS enjoy virtually duty-free access to the EU market, however as long as these preferences are not extended to the rest of the ACP group, unnecessary frictions between countries – sometimes even neighbours – will arise.

The EPAS may change this situation by providing duty-free and quota-free access to the EU markets for all ACP countries, irrespective of whether they are LDCS or not. While such a market opening would represent a positive step for non-LDC countries in the ACP group it would, of course, further reduce the special advantages enjoyed by the LDCS thanks to the EBA initiative.

The incentives for the LDCS who enjoy non-reciprocal benefits in the Cotonou Agreement as well as through the EBA initiative to engage in the EPA process are, understandably enough, limited. The costs of adjustment and implementation are high and certain, while the benefits are highly uncertain.

It is, indeed, difficult to see any advantages for the LDCS in the EPAS.

The controversial EU insistence on reciprocity as well as other EU demands, primarily those related to the “Singapore issues”, casts serious doubts over the future of the EPA negotiations; there are many stumbling-blocks. The ACP countries want to focus on development and policy space, the EU on free trade and additional agreements which surpass WTO requirements in areas such as services, intellectual property rights and “Singapore”.

34 The EU has divided Sub-Saharan Africa into four groups with which it holds parallel negotiations. The four groups are: West Africa, Central Africa, Eastern and Southern Africa and the Southern African Development Community. The two additional groups are the Caribbean and the Pacific countries.

The EU clearly lacks coherence in its policies vis-à-vis the ACP countries. The EU's unwillingness to make commitments concerning its agricultural subsidies and dumping of food surpluses is one, flagrant example. The fishing agreements, which mainly benefit the EU's own fishing sector while contributing to the depletion of ACP countries' fish stocks, is another. A common view among developing countries is that it is even more difficult to raise agricultural policy issues in bilateral trade negotiations, where the OECD countries' domestic producer lobbies have a particularly strong position, than it is in the WTO.

Regionalisation and South-South trade

CHAPTER 14

Parallel to multilateral WTO negotiations, which have temporarily come to a halt, a large number of bilateral and regional trade agreements have been signed, or are under negotiation. The purpose of this chapter is to present a broad overview of recent events in this area, with special emphasis on agreements covering developing countries in general and LDCs in particular. The chapter ends with a brief discussion on the agreement between the United States and 37 countries in Sub-Saharan Africa, the African Growth and Opportunity Act (AGOA).

14.1 Regional trade agreements: rapid expansion

Keeping track of all regional trade agreements (RTAs) that have been signed is next to impossible as the numbers are mushrooming, not least in the last few years. By the beginning of 2005, approximately 170 RTAs, up from 24 in 1990, had been notified to the GATT/WTO (World Bank, *Global Monitoring Report* 2006, p. 95), and one year later the figure had increased to over 250 (*The Economist*, July 8th, 2006). Many more exist, but have not been notified, and at present (end of 2006) the estimated 250+ RTAs covers around one third of world trade while 20 more await ratification and another 70 are under negotiation.

While many new regional trade agreements are being signed there are also, not least in Latin America and Southern Africa, a few examples of a slightly contradictory trend as existing RTAs are put under political pressure.

A selection of major trade agreements signed in 2004–2006 is provided in Table 14.1.

Table 14.1: Major new regional and bilateral trade agreements, 2004–2006

Regional	Year
Central American Free Trade Agreement (CAFTA)	2005
East African Community*	2005
European Union Enlargement (10 new members)	2004
Greater Arab Free Trade Area (GAFTA)**	2005
CAFTA/United States***	2006
Venezuela joins Mercosur****	2006
Bilateral	
Australia/Thailand	2005
Australia/United States	2004
Chile/Republic of Korea	2005
Chile/United States	2004
Colombia/United States***	2006
European Union/Chile	2005
European Union/Egypt	2004
India/Thailand	2005
Japan/Mexico	2005
Peru/United States***	2006
Singapore/United States	2004

* Introduced an external common tariff on January 1, 2005
** The free trade area came into effect 1 January 2005 among 17 Arab states
*** Agreements still waiting for parliamentary approval
**** Previous members: Argentina, Brazil, Paraguay and Uruguay
Source: World Bank, *Global Monitoring Report 2006*, p. 100, and *The Economist*, various issues.

The European Commission has, in particular after the suspension of the Doha Round, been very active in seeking new bilateral agreements (see Section 14.4 below).

There are also examples of trilateral free trade agreements. One interesting example is the proposed, but not yet signed, free trade agreement between three key actors in the South, namely Mercosur, SACU and India.

One reason why regionalisation is a dominant trend in trade policy today is the last few years' impasse in WTO negotiations. Another reason is that many industrialised countries, and especially the United States and the European Union, often find it convenient to engage in bilateral negotiations in the belief that they can dictate the terms more easily than they can in multilateral compromises.

Virtually every developing country is involved in, or is about to negotiate, some form of free trade agreement. A somewhat extreme example is Chile, which is at present party to free trade agreements with over 40 countries.

This process has also been intensified within industrialised country circles. The expansion of the EU and a broadening of the US free trade agreement with Canada and Mexico to include other Latin American countries are typical contemporary examples.

Of all WTO members there is only one – Mongolia – which has not joined a regional or bilateral trade agreement.

In contrast to the rules and regulations of global trade policy, regional and bilateral agreements constitute a wide variety of different forms of trade agreements, each having its own rules and regulations and dispute settlement mechanisms. At the same time, however, it is worth noting that these individual agreements must not contradict WTO rules and regulations and that "substantially all trade" – often interpreted as "90 per cent or more" – must be included in a free trade agreement. In other words, a free trade agreement that only covers one or some sectors is not acceptable. All free trade agreements and customs unions[35] are examined by the WTO – assuming that the states in question are members.

14.2 Regional and bilateral trade agreements: trade creation or trade diversion?

The abolition of tariffs clearly generates more trade. Production will migrate to whichever countries are the most competitive. In the absence of a total end to tariffs worldwide, establishing a customs union and/or a free trade zone can be an important intermediate stage. It can also be viewed as a method for preparing for more far-reaching liberalisation and a way of becoming more competitive. Or at least this is how the WTO likes to regard this contemporary regionalisation trend.

According to theory, both a free trade zone and a customs union should lead to increased trade and so meet the criterion of *trade creation*. This means that competitive advantage will develop in line with the model

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35 In a customs union member states have the same tariffs against third party countries, while each individual member of a free trade agreement retains the right to determine what duties are to be applied to outsiders.

that each respective member of a union/free trade zone will increase its production of the goods and services for which it enjoys a comparative advantage. The assumption is that other countries in the union/free trade zone will import the products in question rather than producing them nationally. This will lead to lower prices and more people will be able to afford to buy more, which is positive for both manufacturing and trade.

At the same time, there could be other countries outside these trading blocs that are actually able to produce the goods in question at a lower cost. However, imports from these countries are more likely to fall than rise because they are not part of the customs union/free trade zone and are therefore subject to tariffs. Consequently, at the initial starting point, i.e. before the customs union/free trade zone was created, this category of countries could have exported more and had the potential to further increase their exports. The introduction of a trading bloc breaks this trend, as the country that has the most competitive production within the customs union/free trade zone increases its production at the expense of countries outside. This phenomenon is called *trade diversion*, and is frequently identified as a major drawback of bilateral and regional, as compared to multilateral, trade agreements. For example, trade between the USA and Mexico within *the North American Free Trade Agreement* (NAFTA) and internal trade in the EU both display signs of substantial trade diversion.

The danger of trade diversion is accentuated by the different rules of origin that are applied in the different trade agreements. For example under NAFTA, a coat is no longer Mexican, and thereby enjoys duty-free access to the US market, if the Mexican producer uses yarn coming from a non-NAFTA country. To complicate things further, the EU and the US have very different criteria for establishing rules of origin.

Free trade blocs/customs unions are either open for additional members to join or closed. As a rule, they generally encompass a limited geographical zone which normally means that only countries within a specific area such as Europe, America or Africa can join. And conversely, countries outside these areas cannot become members. A typical example is the response Morocco received when it applied for EU membership in 1987. The reply made clear that as a non-European country, Morocco was not eligible for membership. (Since Turkey has announced its intention to seek membership, Morocco has questioned this particular EU criterion.)

The relationship between *open* and *closed* regionalism can also be linked to customs union entry criteria for economic convergence and harmonisation of rules and regulations. This does not have to be all-inclusive as other political considerations can govern how de facto open or closed different regionalisation aspirations are.

The concept of *open regionalism* is also used in technical literature to indicate that this is an arrangement that also includes continued parallel liberalisation on a global level – in contrast to earlier regional blocs established in the 1960s and 70s. The *Asia-Pacific Economic Cooperation,* APEC, is often mentioned as a particularly open form of regionalism.

14.3 EU free trade arrangements: current and planned

The EU, which after after the admission of Bulgaria and Romania in January 2007 is composed of 27 members is by far the most important customs union in the world today. The EU's likely continued expansion means that it will become an even more significant trading bloc. Even the countries that are part of *the European Economic Cooperation Agreement,* EEA, namely Norway, Iceland and Liechtenstein should be included in this context as they have been integrated into the ever-expanding European free trade sphere through the Pan-European Cumulation System, which means that all participating nations are allowed to utilise primary products/materials from another country and include processing value in the national origin value.

The EU free trade sphere is under further expansion via new free trade arrangements. EU policy within the framework of *the Barcelona Process* aims to create a large free trade zone between the EU and countries in the eastern and southern Mediterranean plus Jordan (excluding Libya). This free trade policy was set out in the Barcelona Declaration in 1995 which calls for the free trade zone to be established by 2010, which may be somewhat over optimistic. Israel as well as Turkey, Malta and Cyprus also signed the Barcelona Declaration and are to be a part of the future Euro-Mediterranean free trade area. Malta and Cyprus have now become full members of the EU, and Israel and Turkey already have long-term bilateral free trade agreements with the EU. Turkey also has a customs union with the EU which, however, excludes certain products such as agricultural products.

The European Commission is also proposing to launch new bilateral trade agreements with ASEAN, South Korea, Russia and India among others. Negotiations regarding free trade agreements between the EU and the Gulf Cooperation Council, GCC,[36] and with Syria are expected to be finalized in 2007.

Chapter 13 in the Cotonou Agreement noted that the EU's future strategy for the ACP countries would be based on mutuality and free trade

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[36] Since 2003, GCC has been a customs union between six countries and forms part of GAFTA, i.e. the Greater Arab Free Trade Area, comprising 17 Arab states.

arrangements in line with WTO rules. In the first instance this applies to countries that are not LDCs. All in all, this means that the EU sphere of mutual trade preference arrangements may become stronger in the years to come (see the discussion about EPAs in Chapter 13). Increasingly strict requirements will be expected from the developing countries concerned compared with the current situation of unilateral preferences. In this context, the free trade agreement negotiated between the EU and South Africa should also be mentioned.

In July 2000 a free trade agreement came into force between the EU and Mexico. The agreement covers both industrial goods and a substantial number of agricultural products. The agreement is asymmetrical in the sense that the EU undertakes to reduce tariffs more rapidly than Mexico. However both parties are to have eliminated duties on products covered by the agreement within ten years. A similar free trade agreement has been signed between the EU and Chile. Negotiations have also been in progress since 1999 on an association agreement/free trade agreement between the EU and Mercosur.

14.4 Free trade arrangements that include the USA

An expansion of NAFTA is planned on the American continent, as is the creation of a free trade bloc that includes the US and Central America (where, however, opposition has been strong in some of the countries concerned). Parallel with this development, the USA has mapped out the route to an all American free trade sphere, *the Free Trade Area of the Americas*, FTAA. In 1994 the USA and 33 other American countries – excluding Cuba – adopted an action plan aimed at the establishment of an all American free trade area. Negotiations towards such an agreement have, however, been delayed largely as a consequence of political developments in Latin America which have led to the election of governments strongly opposed to the proposed FTAA. Opposition to the FTAA has also been growing in the US, and few observers expect that the project will be realised in the foreseeable future.

The USA and Israel also have a free trade agreement that has been fully operational since 1995. In recent years, the US has signed free trade agreements with Chile and Singapore among others. The US is also a member of APEC, as mentioned earlier.

The AGOA Act, to be discussed below, is a unilateral, non-reciprocal commitment from the US as regards preferential access for African states to the US market. It is not, therefore, an example of a free trade agreement.

14.5 Free trade agreements between developing countries

As the trade agreements between industrialised and developing nations described above have been established, there has also been strong growth in trade between developing countries that can best be described as middle income countries. Numerous new or renewed free trade strategies have taken shape or been revised and extended.

14.5.1 Latin America and the Caribbean

In Latin America special mention should be made of *Mercado Común del Sur,* Mercosur, the largest economic group in Latin America consisting of Argentina, Brazil, Paraguay, Uruguay and, as from 2006, Venezuela. Several other South American countries, including Chile and Bolivia, are associated partners.

Mercosur was founded in 1991 and is today a customs union, albeit with a number of exceptions. Duties on exempted products were to be abolished by 2001.

There is also an umbrella agreement for all cooperation within Latin American, *the Latin American Integration Association* (LAIA); (ALADI in Spanish), that in 1981 replaced an earlier initiative *the Latin American Free Trade Area,* LAFTA, dating from 1960. The aim is to eventually create a regional common market. To date LAIA has played a very limited role in moves to develop regional integration.

The Andean Pact is another South American trading bloc. It was formed in 1969 by Bolivia, Chile, Colombia, Ecuador and Peru. Venezuela became a member in 1973. Recent political events have however caused Venezuela leave the Pact in 2006 (and become a member of Mercosur instead). Chile left the Pact already in the 1970s. With the 2005 cooperation agreement between the Andean Pact and Mercosur Argentina, Brazil, Paraguay and Uruguay were granted associate membership.

Five countries in Central America (Guatemala, El Salvador, Honduras, Costa Rica and Nicaragua) have also created a *Central American Free Trade Area,* CAFTA, with an internal free trade zone and a common external tariff barrier. The majority of internal trade barriers have been removed, but the process has been rather long-drawn-out. Two of the member states, El Salvador and Guatemala have resolved to take a step further and establish a bilateral customs union. Negotiations with the United States on the formation of a free trade area covering CAFTA and NAFTA, and with the Dominican Republic as an additional member, are underway, however they have met with widespread opposition in several Central American countries.

There is also the *Caribbean Community and Common Market,* CARICOM. Virtually all the Caricom countries are also part of the ACP group that signed the Cotonou Agreement with the EU. The member states have signed far-reaching agreements designed to create a common market. However the ratification and implementation process is proceeding very slowly, and effects have so far been limited. Nonetheless, significant trade liberalisation progress has been made and a common customs tariff is in the process of introduction.

14.5.2 Asia

The best known organisation in Asia is *the Association of Southeast Asian Nations,* ASEAN, within which a free trade agreement was reached in 1993, *the Asian Free Trade Association,* AFTA, whose goal is to have abolished tariffs inside the group within 15 years.

In the mid 1980s, seven countries in Southern Asia initiated *the South Asian Association of Regional Cooperation,* SAARC. In 1993 *the South Asian Preferential Trade Agreement,* SAPTA was established. Several negotiating rounds have taken place within the framework of this agreement. Progress towards a duty-free zone has been slow and the deadline has been extended to the year 2008 for non-LDCS and to 2010 for LDC members. There are also plans to establish a customs union by 2015 and a common monetary and economic policy by 2020.

The Arab world has made great advances in forming a regional trade bloc (GAFTA – see Section 14.4 above).

14.5.3 Africa

Ever since independence, African countries have made many attempts to create various cooperative organisations in order to increase trade and promote industrialisation through integration. So far with very limited success. However in light of the ever-growing trend towards regionalisation in various parts of the world along with continued globalisation, many African states are also trying to develop partnerships. The EU has also expressed a wish that the African ACP states which have signed the Cotonou agreement should develop free trade blocs.

As discussed in the previous chapter, EU has set out proposals on how a transition to free trade agreements with individual or groups of African countries could be carried out within the framework of regional EPAS, *Economic Partnership Agreements.*

Within the *Organisation of African Unity,* OAU, various initiatives have been adopted to create a pan African free trade zone. In 1994 *the Common Market for Eastern and Southern Africa,* COMESA, was established, replacing the earlier *Preferential Trade Area,* PTA. COMESA's principal goal was to establish a free trade zone and then take the next step of realising a customs union. Long-term goals also include a common regulatory framework for investments and standards and a harmonisation of macroeconomic policy-making within the group.

Currently, COMESA has 20 member states and a population of around 400 million. Internal trade between members has increased more than fivefold since the early 1990s and accounts today for around five per cent of the member countries´ total trade.

As an organisation COMESA has been granted observer status at the WTO. The organisation has also established common positions for member states as preparation for the next WTO round.

Large parts of COMESA overlap with another important African organisation, *the Southern African Development Community,* SADC. This organisation's aim is to create wide-ranging economic cooperation between all member states and to establish a free trade zone. However, regional conflicts, mainly the war in the Congo, have created problems in implementing the SADC action programme. Several of the 14 member countries are experiencing major economic problems and it is estimated that 40 per cent of the almost 200 million inhabitants in the region live in extreme poverty. Current debates on regional integration in southern Africa are, among other things, focusing on transforming SADC into a customs union and a common market for goods and services, but many difficult questions – not least related to the outcome of the EPA negotiations – remain to be solved.

In this context it is worth mentioning the longstanding *Southern African Customs Union,* SACU. The fact that South Africa has entered into a free trade agreement with the EU has complicated matters within SACU.

Yet another noteworthy example is the *East African Community,* EAC, which has a long history[37] and consists of Kenya, Tanzania and Uganda. The aim is to create a customs union and common market for goods and services and the free movement of labour and capital.

In West Africa there is another organisation, *the Economic Community of West African States,* ECOWAS. Like the other organisations already discussed, ECOWAS aims to eliminate tariffs between member states and to create a common market with common tariffs vis-à-vis third party countries. The economic policies of member countries are also to be harmonised, and a monetary union established. However, this region has also

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37 Indeed, already in 1917 a customs union between the British colonies Kenya and Uganda was formed, which the then Tanganyika later joined in 1927. The current treaty for the establishment of the East African Community was signed in Arusha in 1999.

been torn by wars and crises that have prevented any great progress in the spirit of ECOWAS.

The *Union Economique et Monétaire Ouest-Africane,* UEMOA, is another organisation worth noting. Its common denominator is ties to the French Franc. The organisation was restructured in 1994 when it adopted its current name. The restructuring project was designed to make the organisation more efficient, something that has been only partially achieved.

There is also *The Arab Maghreb Union,* AMU, established in 1989. The aim was to create an integrated market and build a partnership that embraced economic, social and cultural areas. However the issue of Western Sahara has been a stumbling block preventing cooperation to date.

14.6 The African Growth and Opportunity Act (AGOA)

The African Growth and Opportunity Act (AGOA) was promulgated in the United States with the aim of liberalising trade between the US and 37 designated Sub-Saharan (SSA) countries. The Act, passed by the US Congress in 2000, originally covered the period from October 2000 to September 2008, but amendments signed into law in July 2004 further extended AGOA until 2015.

AGOA builds on existing US trade programmes by expanding the duty-free benefits previously available only under the Generalised System of Preferences (GSP) programme.

In just a few years, AGOA exports to the United States have increased from BUSD 22 in 2002 to BUSD 47 in 2005, and the US trade deficit with the 37 AGOA countries has widened considerably, to reach BUSD 37 in 2005. A limited number of oil exporters – Nigeria, in particular, and Angola in second place – account for a very large share of the US deficits. African exports to the USD market remain heavily dominated by oil and other minerals.

While many observers argue that AGOA has been instrumental in increasing African exports to the US market in recent years, critical voices have been raised. In particular, the existence of a number of products excluded from duty-free access severely restricts market access for many products of great interest to Africa. The complicated rules of origin – which, however, are more generous than those applied by the EU – also act as a barrier to trade (for further information about AGOA, see www.agoa.info).

Criticism has also been stated against the many conditions attached to the AGOA preferences. For example, the long list of eligibility criteria established by the US Congress includes the requirement that African countries minimise government interference in the economy.

14.7 LDC opportunities for increased regional trade and South-South cooperation

The above account of a selection of free trade agreements affecting developing nations reveals that, generally speaking, virtually all developing countries including LDCs have entered into some form of free trade arrangement. A great many developing nations are also party to more than one agreement.

In addition, there are many examples of developing countries such as India and Brazil which give special trade preferences to less-developed countries, sometimes under UNCTAD's "Global System of Trade Preferences among Developing Countries" (GSTP), composed by more than 40 members of the G77 group of developing countries. The GSTP, which aims at trade liberalisation among developing countries, recognises the needs of the LDCs which are not required to make trade concessions on a reciprocal basis.

Certain free trade initiatives have been realised in full or in part, and the establishment of customs unions beckon. At the same time, there are plenty of examples of total or partial failures. Delays in timetables for tariff abolition are not uncommon. Yet despite all the shortcomings, efforts to achieve greater integration have intensified and interregional trade is important – also between LDCs – in Africa.

As the majority of LDCs are, to a large extent, raw materials exporters, their markets are mainly not other LDCs but industrialised countries and, to a increasing extent, the rapidly industrialising developing nations such as China, India, Brazil and ASEAN.

While demand for the type of raw materials produced by LDCs remained rather stagnant during the 1980s and 1990s, rises in exports of these products tended to result in falling prices rather than increased export revenue. As indicated earlier in this study, the last few years have witnessed a reversal of this trend so terms of trade for the majority of LDCs, especially African LDCs, have recovered (although a number of oil-importing countries have suffered more from higher oil prices than from improved export prices). While this is an extremely positive trend, there is also a danger that the pattern of trade already established – with poor countries exporting raw materials and importing finished goods and services – will be further reinforced by a combination of rising commodity prices and free trade agreements between more and less developed countries.

In addition, the physical infrastructure within and between LDCs is often so poor that it can be both more difficult and more expensive to develop effective regional trade than to import the products concerned from an industrialised country, which for African states often means their former colonial rulers.

Bearing these caveats in mind, it must however be concluded that regional trade agreements and a further increase in south-south trade are very encouraging developments for the LDCs. It should also be emphasised that LDCs and other low-income countries no longer have to "look North" to find what they need. The fact that a number of developing countries, not least in Asia, have undergone remarkable economic and social development indicates that they are today able to offer LDCs what used to be available only in the OECD countries, namely market access, capital, technology and human resources.

The Doha Round: limited progress and major stumbling-blocks

CHAPTER 15

The main purpose of this chapter is to discuss the WTO Doha Round, which was launched in late 2001 and lasted until the suspension of the Round in July 2006. After a brief background, the chapter continues with a discussion of a number of issues which we consider of special interest to the LDCs, followed by a review of more issues mainly promoted by the OECD countries. The chapter also makes a brief assessment of an area where some progress was made during the Doha Round, namely the increase in trade-related ODA ("Aid for Trade").

15.1 Background to the Doha Round: LDC priorities

Although neither the developing countries as a whole nor the LDCs presented a common, coherent position before the Doha Summit in late 2001, below is a brief summary of the WTO issues that this study considers crucial from a broader developing nation perspective, and which are most important for the LDC group specifically.

Important issues for developing countries in general:

- Increased market access, especially for agricultural exports;
- Reduction of all trade-distorting OECD country agricultural subsidies;
- Restrictions, and preferably a ban, on the use of anti-dumping and countervailing measures against developing countries;
- Institutional reforms of WTO in order to make it easier for developing countries to participate;
- More flexible instruments for STD (special and differential treatment).

Issues of special relevance to the LDCs:

- The preservation of the principle of non-reciprocity and specific advantages for developing nations and LDCs in particular;
- Greater flexibility for the LDCs in implementing the TRIPS and TRIMS agreements. They should be entitled to decide themselves when the time is right for them to implement the various parts of the agreements;
- A reduction of direct costs to LDCs for implementation of the Uruguay Round agreements, through ODA in combination with less strict requirements in certain parts of the agreements;
- Increased support to the strengthening of the trade policy capacity of the LDCs, i.e. their ability to identify and promote their national interests.

15.2 Controversial issues promoted by developed countries

When plans for a major new round of WTO negotiations floundered at the Seattle World Summit in December 1999, it was the reluctance of the developing countries rather than the demonstrators on the streets outside that proved decisive. The number of developing country members at the WTO had increased considerably since the Uruguay Round, and this new majority began to make its presence felt; some observers even described the Seattle meeting as a "revolt" by the developing countries.

The non-transparent and undemocratic nature of the Seattle summit – symbolised by the "green room" process, which involved a small number of powerful countries discussing key issues while the majority of WTO members were excluded – was subject to much criticism and African ministers in particular expressed strong feelings about being marginalised.

For a number of years the EU had been the most prominent advocate of a new round of negotiations, where they wished to include a series of "new issues" such as investment, competition, labour and the environment. The EU's primary motive for a broad round was a wish to balance out the agriculture talks – where the EU had and has defensive interests – with areas where they were on the offensive. Off the record, it was well known that the EU did not want to enter into serious talks on agriculture unless there was a new round.

For their part, the developing countries stubbornly argued that they were unwilling to enter into new negotiations until various outstanding issues concerning the implementation of the Uruguay Round had been resolved. In plain English: the developing countries would not accept new negotiations until they had seen some tangible results from the agriculture and textiles agreements.

Another reason why the developing countries were so hesitant was that these "new issues" – just as the TRIPS Agreement, for example – would affect central areas of national policy, not only trade policies.

A short resume of these new and highly controversial issues is provided below. The first four of these issues – investment, competition, transparency in public procurement and trade facilitation – are the so-called "Singapore issues" briefly mentioned earlier which the OECD countries wanted to put on the agenda at the first WTO Ministerial Meeting in Singapore in 1996.

15.2.1 Investment

Discussions concerning investment were initiated in WTO in 1996. Following the failure of OECD negotiations on a Multilateral Agreement on Investment (MAI) in 1998, the WTO appeared to be a possible forum for future negotiations in this area. Given the existence, in the late 1990s, of around 1,500 bilateral agreements regulating terms and conditions for corporate investments in bilateral partner countries, MAI was designed to improve the climate for international investments by creating similar rules in all participating countries and also to accord foreign corporations "national treatment" in accordance with basic GATT/WTO principles. The MAI also included far-reaching rights to compensation in the event of, for example, expropriation. The proposal was very comprehensive and based on very broad definitions of "expropriation" and "investment", which even extended to the pre-investment phase.

Investment rules within WTO could mean that the TRIMS rules, which only apply to trade related investment measures, would also apply to all foreign investments, including production for the domestic market. Although a few, more advanced developing countries (mostly in Latin America) expressed a great deal of interest in the MAI Agreement, the vast majority of developing nations remained sceptical about both MAI and investment negotiations within the WTO. This is mainly due to concerns that an agreement would restrict their freedom to regulate and control foreign investment in line with their own national interests.

It is worth noting that the current GATS and TRIPS and – in particular – TRIMS agreements all touch on investment issues.

15.2.2 Competition

Trade and competition have been discussed within the WTO since 1996. These discussions are motivated by the fact that lack of competition legislation in certain countries risks undermining the effects of trade liberalisation. The ultimate aim of these negotiations is to create a multilateral framework for national competition legislation. To date the most sensitive issue (where the OECD countries strongly disagree) has been to what extent the discussions should also include the competitive consequences of anti-dumping and countervailing duties.

In general, developing countries and LDCs lack advanced competition legislation. The numerous mergers between multinational corporations, along with the wave of privatisation of publicly owned monopolies that have swept the world have, however, clearly demonstrated the need for competition policies in the developing world too. Nonetheless, there are reasons why countries at different stages of development need different types of competition policy. Many developing countries pursue, just as Japan previously did with great success, a policy that does not have free competition as its ultimate goal but which in certain cases favours the growth of major domestic companies. From a dynamic perspective, this may be better for economic growth within the country than encouraging static economic efficiency by maximising competition.

Many developing countries are totally opposed to competition discussions in the WTO, while others have argued that the development dimension must be taken into account. Developing country doubts are probably based on concerns that future international rules would hamper the growth of major national corporations by forcing them to compete "on equal terms" with major foreign corporations. In many cases, however, national companies would never be able to compete with multinational corporations who possess such advantages as global economies of scale, if they had to do it on equal terms.

Once again, this is an area where it can be questioned whether current legislation in industrialised countries should be the norm for LDCs and developing countries which are currently experiencing totally different needs. This is not to deny that both developing and industrialised countries might need a global competition law that could address these issues which are becoming more and more urgent as global industries, such as those in the automobile and pharmaceuticals sectors, become increasingly concentrated. However this has not been the primary aim of the discussions within WTO.

15.2.3 Transparency in public procurement

Regulations concerning government procurement have traditionally been kept out of key market-access rules undertaken by countries under both GATT and GATS. The GATS Agreement does state, however, that multilateral negotiations on government procurement of services should be carried out in the WTO. In addition, a WTO "Working Group on Transparency in Government Procurement Practices" has been set up, and plurilateral Government Procurement Agreements (GPAs) have been signed by a number of countries. So far, only countries in the category of "high human development" in the UNDP index are signatories of the GPAs, which are of a voluntary character, i.e. not part of WTO's "single undertaking".

It is indisputable that public procurement forms a very important element of every country's economy. The OECD has estimated that spending on public procurement at all levels amounts to figures which are close to the total value of global trade, and some estimates[38] indicate that public procurements in the OECD countries amount to between 10 and 15 per cent of their GDP.

It is also clear that there are huge gains to be made, not least in developing countries, in improving the efficiency of public spending if accountability is enhanced and more transparent and competitive procedures for public spending can be enforced.

Thus, on a purely technical level, great improvements can and should be made in areas such as effective advertisement, the preparation of well-formulated bidding documents, open disclosure of bid evaluation criteria, the establishment of regulatory and surveillance bodies as well as transparent appeal mechanisms.

For developing countries, better public procurement procedures and stronger competition can be important tools to use to reduce costs, improve the quality of goods and services purchased by government agencies and reduce the risk of corruption. A global regulatory framework may also make it easier for developing country companies to obtain better access to public procurement contracts in OECD countries. It is, however, the developed countries and in particular the EU which have insisted on putting the issue of public procurement on the WTO agenda. The main objective has been to gain improved market access through a gradual elimination of preferences granted to national suppliers; one central purpose of the GPAs is that all members' public procurement must be open to international competition. According to the advocates of more manda-

38 See Swedish National Board of Trade (2004, p. 107).

tory regulations, future WTO negotiations should aim at achieving worldwide acceptance of the basic GATT/WTO principle of national treatment, i.e. non-discrimination, in the area of public procurement as well.

Concerns in developing countries have centred around the loss of domestic "policy space", and the potentially large losses of contracts for domestic suppliers that a complete liberalisation of government procurement might lead to. To date, developing countries have been successful in preventing further binding multilateral agreements, but the EU still wishes to include the issue of public procurement in its bilateral trade agreements, including the ongoing EPA negotiations with the ACP countries.

15.2.4 Trade facilitation

Trade facilitation is not a very controversial topic, and is therefore the only "Singapore issue" which has remained on the WTO agenda. Essentially, trade facilitation is about reforming trade procedures and reducing transaction costs.[39] In other words to simplify and standardise procedures related to foreign trade, and to reduce or remove fees related to cross-border trading. An additional benefit may be increased transparency and reduced scope for corruption.

The direct and indirect costs arising as a result of inefficiency and red tape can be very high. This is particularly the case in the agro-food sector, since border delays can be devastating for perishable goods. Agricultural products are also subject to additional border procedure and documentation demands related to sanitary and phytosanitary requirements (for a discussion, see Swedish National Board of Trade, 2006a, pp. 104 ff.).

Developing countries have much to gain from improved trade procedures, not least on the import side. Many of the improvements needed require substantial investments in administrative skills and customs procedures, however, and the issue of trade facilitation in developing countries has often been emphasised as a key area for international support.

15.2.5 Labour

In response to demands from their trade unions, for a number of years the USA and EU have sought to discuss the link between trade and labour standards. When the issue was discussed at the first WTO Ministerial Conference in Singapore in 1996, the matter was referred in its entirety to the ILO, although several countries have continued to attempt to add it to the WTO agenda. The discussion has essentially been about a handful of ILO

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39 The origin of the WTO trade facilitation negotiations can be found in three old GATT articles: Art. V, "Freedom of transit", Art. VIII, "Fees and formalities connected with importation and exportation" and Art. X: "Publication and administration of trade regulations."

Conventions, the core labour standards, mainly freedom of association and right to collective bargaining and the bans on child labour, forced labour and discrimination against workers. Advocates of a social clause would like to link these labour standards to WTO rules.

Linking trade agreements to labour standards has, however, been like a red rag to a bull for most developing nations, who fear that industrialised country interest is motivated by a desire to exclude low-wage competition by creating a level playing field, rather than through genuine concern for the work force. The industrialised countries have long denied that they wish to link labour standards to trade barriers, however President Clinton's speech in connection with the summit in Seattle in 1999 where he did not rule out the possibility of using trade policy instruments against countries violating labour standards, demonstrated that developing countries have cause for such concerns. Clinton's remarks, which were not applauded by the EU or Japan, were a contributory factor to the developing countries' initial refusal to agree to a new round.

The issue of putting labour standards on the WTO agenda has been almost dormant during the Doha Round, but it may come back. It is present in a number of bilateral trade negotiations; the EU, for example, wishes to include labour standards in its negotiations with the ACP countries over the controversial Economic Partnership Agreements.

15.2.6 Environment

Environmental issues were discussed at WTO throughout the entire 1990s but as in the case of labour standards, they received scant attention during the Doha Round.

The developing nations have constantly been sceptical regarding talks on the relationship between trade and the environment, mostly because they are afraid that industrialised countries are going to introduce new trade barriers under the guise of environmental protection. According to the current interpretation of WTO rules, countries may not restrict the import of goods on the grounds of the negative environmental impact of their production (unless this is mirrored in the qualities of the finished product).[40] It is worth emphasising however that increasing environmental demands on industrialised country markets do not necessarily, or in all cases, make it more difficult for developing countries to market their products to consumers in the North. For example, developing countries

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40 A dispute in the WTO on shrimp catches has however demonstrated that the rules are not always interpreted in this manner. According to a much publicised Appellate Body ruling in the late 1990s, the United States was allowed to retain its imports barriers against shrimp that had been caught in a manner that also caused the death of endangered sea-turtles.

and LDCs both have good opportunities to gain a foothold in expanding markets for organic foods, if teething troubles with certification etc. can be resolved.

Apart from the genuine concerns that WTO rules would pave the way for "green protectionism" there are reasons to believe that many developing countries are opposed to these discussions for tactical reasons. The environment is regarded as a bargaining chip in a larger game; if the industrialised countries genuinely want action on the environment they will have to make concessions in the area of agriculture, for example.

In WTO discussions, subsidies and other trade obstacles that not only distort the world market but also exacerbate environmental problems – such as agriculture and fishing subsidies – have been increasingly highlighted in recent times. This is an area in which developing countries have shown great interest.

Not least as a consequence of the enhanced recognition worldwide of the dangers associated with global warming, environmental issues are likely to move higher up on the agenda in a possible future round of negotiations.

15.3 The "Doha Development Round"

15.3.1 The Doha Ministerial Conference in 2001

Added to the list of non-resolved controversial issues mentioned above there were also the "old" issues related to agriculture, textiles and clothing, services, TRIPS, TRIMS, special and differential treatment and many others which were expected to complicate the WTO Ministerial Conference in Doha, Quatar, in November 2001.

The Fourth WTO Ministerial Conference gathered shortly after the dramatic and tragic events of 11 September 2001. The sympathy that the United States could count on after the terrorist attacks contributed to influencing the atmosphere at the Doha meeting, making it more conciliatory in both tone and content. Indeed, the Doha meeting is by many observers regarded as the most successful Ministerial Conference since the foundation of WTO. In order to underline the willingness of all WTO members to grant priority to the needs of the developing countries, the new round of negotiations was labelled "The Doha Development Round", and the unanimously adopted Doha Declaration emphasised that development concerns would be of special importance on the "Doha Development Agenda" (DDA).

In agriculture, the key issue for the majority of developing countries, the member states committed themselves to negotiations "without prejudging the outcome", however, aimed at "improved market access and substantial reductions in trade-distorting domestic subsidies". The most binding commitment appeared to be the commitment to undertake "reductions of, with a view of phasing out, all forms of export subsidies".

The developing countries failed to gain acceptance for their proposal to create a "development box", or "food security box", which would provide greater latitude for developing country agricultural support measures.

As to non-agricultural market access (NAMA), the ministers agreed to launch tariff-cutting negotiations on all such products. The aim was stated as to "reduce, or as appropriate eliminate tariffs, including the reduction or elimination of tariff peaks, high tariffs and tariff escalation, as well as non-tariff barriers, in particular on products of interest to developing countries". The negotiations should take fully into account the special needs and interests of developing and least-developed countries, and the Declaration recognized that these countries would not have to match or reciprocate the tariff-reduction commitments made by other member countries.

The Doha Declaration confirmed the WTO's special provisions for developing countries called Special and Differential Treatment (STD – see Chapter 7), in particular longer time periods for implementing agreements. In what may be interpreted as a vague promise the WTO members signing the agreement also agreed "that all special and differential treatment provisions shall be reviewed with a view to strengthening them and making them more precise, effective and operational" and confirmed their willingness to pay attention to "the specific constraints faced by developing countries, particularly least-developed countries".

The Doha meeting also confirmed, against the will of many developing countries, the right of the ACP countries to maintain their special trade preferences granted by the EU in the Cotonou Agreement. Promises to increase trade-related development assistance to help developing countries to enhance their capacity to implement the WTO agreements and to enhance their participation in global trade also formed part of the DDA.

Negotiations on the controversial "Singapore issues" did not move forward however the OECD countries, and the EU in particular, did manage to include commitments to put these issues on the agenda in subsequent negotiations during the Doha Round. The same is true for labour standards, where the Declaration limited itself to a vague reaffirmation of "our declaration made at the Singapore Ministerial Conference regarding internationally recognized core labour standards".

The launching of the Doha Development Round created high expectations, however with hindsight it is easy to see that the commitments of most interest to developing countries were worded in exceedingly vague terms, while the OECD countries managed to retain virtually all controversial issues on the agenda.

15.3.2 The Cancún Ministerial Conference in 2003

Just as at the Seattle Conference four years earlier, the Cancún Ministerial Conference in November 2003 broke down without a common declaration. This time, developing countries arrived at the conference with firm positions on a wide range of issues, and for the first time since the establishment of the WTO they participated actively in the negotiations in a way that went far beyond the blocking role played in Seattle.[41] Strong developing country coalitions such as the G20 – or G20 plus as it was called when many developing countries joined the group – emerged. The G20 group included important countries like India, Brazil and South Africa from all developing regions (but no LDCs), and they came to Cancún with highly skilled and well-prepared delegations. To the surprise of many delegates from the North, the negotiation coalition formed by an increasing number of countries managed to maintain a high degree of coherence and determination.

One very interesting phenomenon witnessed in Cancún was the alliance that developed on a number of issues between the LDCs and middle-income countries. An illustrative example was the widespread support extended by all developing countries to four cotton-producing LDCs in West Africa – Benin, Burkina Faso, Chad and Mali – which demanded a substantial reduction of US trade-distorting cotton subsidies which eroded world market prices and thereby the livelihoods of large numbers of low-income cotton producers. Attempts to force the US modify its position failed, but the "cotton battle" became a symbol of developing country solidarity.

The issues of Special Products and Special Safeguard Mechanisms (see Chapter 10) were also forcefully promoted by a large majority of developing countries, but met with considerable resistance from the OECD camp.

The Cancún Ministerial Conference ended, as did the Seattle meeting four years earlier, in failure and the delegates went home without a joint ministerial declaration.

The interpretations as to why the Cancún Conference collapsed vary greatly between different observers, but the failure to make progress on agriculture was certainly a key factor. One common opinion among developing country members was that no agreement in Cancún was better than a bad agreement.

41 For a useful overview, see, for example, Grant (2006).

15.3.3 The Hong Kong Ministerial Conference in 2005

The trend towards more and more active participation from groups of developing countries witnessed during the Uruguay Round was further confirmed during the Doha Round. When the 6th Ministerial Conference gathered in Hong Kong in December 2005, all developing countries came together in a grand coalition under the name of the "G110" and issued a joint statement emphasising the importance of development concerns.

The positions adopted by developed and developing countries were similar to those witnessed in Seattle and Cancún. The former would like to see more progress on NAMA – basically reduction of tariffs on industrial products – and greater liberalisation commitments on services by developing countries. The EU, in particular, also wished to promote some of the controversial "Singapore issues". The developing countries had different interests on a number of issues – such as the concerns regarding "preference erosion" especially on the EU market expressed by many ACP and LDC countries – but were in basic agreement on the need to advance on a reduction of OECD country agricultural subsidies and dumping of food surpluses. Leading developing countries such as Brazil and India even made it clear that progress on agriculture would be a *sine qua non* for progress on NAMA and services liberalisation. In addition, there were a number of old issues – such as Special and Differential Treatment, non-tariff barriers to trade, food security and the need for Special Safeguard Mechanisms and an enhanced "policy space" in general, TRIPS and TRIMS and others – where developing countries were fairly united.

As an expression of developing countries' increased activity, a number of declarations from different groups of developing countries, including a special declaration from the LDC group known as the Livingstone Declaration, were issued prior to the Hong Kong meeting.[42] The common LDC position, as reflected in the Livingstone Declaration, included expressions of concern:

- on the lack of progress and poor reflection of development issues in the Doha Work Programme;
- on the slow progress on Special and Differential Treatment;
- on the slow progress in finding a permanent solution through amendment of the TRIPS agreement to enable countries with insufficient manufacturing capacity to access pharmaceutical products at affordable prices, and
- on the continuing onerous demands made by some WTO members concerning the LDCS' accession process.

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42 A useful summary of these declarations is found in Manduna (2006).

The Declaration further requested:

- binding commitments by developed countries and "developing countries in a position to do so" on duty-free and quota-free market access to all products from all LDCs on a secure, long-term and predictable basis without restriction;
- a moratorium by developed countries on safeguard and anti-dumping actions against LDC exports;
- complete exemption for LDCs from any tariff reduction commitments;
- a further strengthening of the existing preferential schemes and the incorporation of provisions in the modalities to address the erosion of preferences;
- flexible and simplified provisions concerning rules of origin, certification and inspection requirements and technical and safety standards.

The Declaration also called for the complete elimination of all export subsidies for cotton, debt cancellation for all LDCs, increased levels of trade-related ODA and, in general, for increased "policy space" and flexibility in the LDCs' implementation of WTO agreements.

As to the results of the Hong Kong Ministerial, the most positive thing that can be said was that the meeting did not collapse as in 1999 and 2003. However the final declaration can best be described as a much watered-down compromise. Little progress was made on agriculture; the commitment to put an end to all export subsidies by the end of 2013 can be interpreted as a reaffirmation and concretisation the Doha decision from 2001, but developing countries had asked for an earlier date. It must also be observed that export subsidies represent a very tiny part of all OECD subsidies to agriculture; they constitute, for example, less than four per cent of the EU's total farm support. The language used in the Ministerial Declaration for domestic support – the old discussion about permitted and non-permitted farm support "boxes" – was intentionally vague, and most of the work on agriculture was postponed – initially until April 2006, when major agreements were scheduled.

A similar analysis can be made of the outcome of the "cotton dispute" (see Chapter 1.4). The US did promise to end its export subsidies, as demanded by the developing countries, but nothing was decided about the much more extensive domestic support which is far more price-depressing than export subsidies.

The NAMA negotiations, in which the developed countries demanded substantial progress, stalled over differences on the type of formula to be used for tariff reduction and the nature of the flexibility to be extended to developing countries. NAMA issues were therefore also postponed, together with trade in services and a number of other controversial issues.

During the first half of 2006 WTO negotiations continued, but deadlines for a major breakthrough were put off time after time. In July a decision was taken to suspend the entire Doha Development Round. The reason given was the inability of major trading partners to reach an agreement on the key issues discussed earlier. The most commonly identified, major stumbling-blocks are US unwillingness to make commitments on agricultural subsides, EU unwillingness to offer improved market access for agricultural products and the unwillingness of major developing countries (such as India, Brazil and South Africa) to offer concessions on NAMA and services.

It is today – January 2007 – difficult to forecast if and when the Doha Round of negotiations will be resumed, let alone concluded. While much "silent diplomacy" is underway with the objective of rescuing the Doha Round, an agreement including the United States would, according to most observers, have to be reached before mid 2007. The reason for this unofficial deadline is that the US Trade Promotion Authority (TPA) – the so-called "fast track", i.e. the negotiating license that the White House has been given to conclude trade deals without having to consult Congress – expires in June 2007. The TPA will hardly be extended by a Democratic Congress majority during a pre-election year, especially as the exceedingly large trade deficits registered by the US economy in recent years are likely to make the US political atmosphere less and less free trade-friendly.

In the meantime WTO negotiations in various specialised committees and working groups will continue of course. But the trend towards bilateral and plurilateral deals at the expense of multilateral agreements which has dominated global trade policy during the last few years is likely to become further accentuated as long as the WTO impasse lasts. For the LDCs, this is not a very encouraging scenario.

15.4 Aid for Trade

International support to enable developing countries to increase their participation in world trade, and to facilitate their implementation of WTO agreements, has been an important part of the Doha Development Agenda. The 2001 Ministerial Declaration was very explicit in making technical and financial assistance a right of development countries, and this commitment was reiterated in the 2005 Ministerial Declaration, which stated (paragraph 57): *"Aid for Trade should aim to help developing countries, particularly LDCS, to build the supply-side capacity and trade-related infrastructure that they need to assist them to implement and benefit from WTO Agreements and more broadly to expand their trade"*.

Aid for Trade – sometimes abbreviated into the acronym A4T – has been one of the few areas where some progress has been made since 2001 (although actual trade-related aid disbursements still fall appreciably short of commitments). A special A4T Task Force has been set up, and in October 2006 the WTO General Council endorsed a number of Task Force recommendations about increased trade-related assistance to developing countries in general and LDCS in particular.

Aid for Trade is not a new concept. As early as 1996, the Integrated Framework (IF) for Trade-related Technical Assistance to the Least Developed Countries was established (and renewed in 2000) as a means of coordinating the various bilateral and multilateral aid agencies providing trade-related technical assistance to LDCS. The IF is comprised of six multilateral agencies: The IMF, the ITC (International Trade Centre), UNCTAD, UNDP, WTO and the World Bank.

Working in close cooperation with the IF, a Joint Integrated Technical Assistance Programme (JITAP) has been set up to assist countries in sub-Saharan Africa to improve their participation in world trade. JITAP is a collaboration between the WTO, UNCTAD and the ITC.

In terms of aid volumes both the IF and JITAP are, however, of marginal importance compared to bilateral trade-related assistance from the US and the EU.

The IMF also set up its own Trade Integration Mechanism (TIM) in 2004 to assist low-income developing countries to meet balance of payments shortfalls that might result from trade liberalisation, for example from trade preference erosion or loss of textile quotas as a result of the abolition of the Multi-fibre Agreement (MFA) in 2005. So far, three countries have received IMF financing in accordance with the TIM: Bangladesh, the Dominican Republic and Madagascar. In all three cases, the purpose has been to ease possible balance of payments pressures stemming from the abolition of the MFA (Andersson et al., 2007, forthcoming).

While developing countries have expressed their appreciation of the many trade-related aid initiatives that have been taken, there is also widespread disappointment over the slow pace of disbursement. Developing countries have also argued that A4T should be regarded as additional to ordinary ODA.

A somewhat different concern has been that A4T is largely donor-driven – with major OECD countries such as the US and the EU in the driving seat – and that part of the aid comes with explicit or hidden conditions based on a trade liberalisation, rather than development, agenda. The developing countries have therefore consistently maintained that A4T should be demand-driven, and that no such aid should have any link with the recipient country's "good behaviour" in trade negotiations and its compliance with particular WTO regulations.

As regards the agenda for A4T, there is a clear shift in emphasis from the first years when most attention was paid to explicitly trade-related technical assistance, largely associated with the implementation of WTO regulations. Today, A4T is more directed to easing supply-side constraints in trade-related infrastructure – transport and storage, communications, energy and others – as well as institution-building in areas of more indirect trade relevance such as banking and financial services, agriculture and tourism. While the border between ordinary development aid and A4T consequently becomes increasingly blurred, the broadening of the aid-for-trade agenda implies a healthy movement away from "compliance-oriented" technical assistance – dominated by short courses during which government officials are given information about how to comply with WTO regulations – to aid addressing key supply-side constraints. A major challenge is to integrate trade concerns into overall development cooperation and policy ("mainstreaming").

In terms of aid volumes, aid that is classified as trade-related support to infrastructure and productive sectors and that is managed in the usual way by the bilateral donor community, is far larger than technical assistance to trade policy regulation, implementation and capacity-building.[43]

Part of the A4T package also has the objective of easing adjustment costs related to trade liberalisation and policy changes.

Using the broad A4T classification, the commitments made by major donors are major. For example, the EU and its member states have pledged to provide BEUR 2 in trade-related assistance by 2010, while the US has announced grants of BUSD 2.7 a year. Japan has committed BUSD 10 over 2007–2010 for trade-related infrastructure, production and distribution (OECD 2006b). These pledges are, however, surrounded by many question marks as regards both future disbursements and design.

It may finally be mentioned that among the many initiatives taken to support capacity-building in trade policy issues, a Swedish decision to support a trade policy training centre especially designed for LDCs has recently been taken. The Centre, Trapca (Trade Policy Training Centre in Africa), inaugurated in December 2006 and located on the premises of

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43 For data see, for example, OECD (2006 b).

ESAMI (Eastern and Southern African Management Institute) in Arusha, Tanzania is offering a wide variety of short and long-term courses in trade policy, including a Masters programme. One central objective of the Centre is to offer training on a high academic level which is tailor-made to the specific needs and conditions of LDCs and which will have a considerable degree of African ownership.

Summary and recommendations

CHAPTER 16

16.1 Summary of conclusions

16.1.1 Stagnation and marginalisation of LCDs

Despite the economic recovery enjoyed in the last few years, the LDCs have become successively marginalised in the global economy. They contain more than ten per cent of the people of the world, while their share the world's production is less than one percent. Their share of world trade has continuously decreased and is currently only around one half of one percent.

Sweden's annual exports are five times greater than the total exports of all LDCs together. Only 0.2 percent of the world's direct investments goes to LDCs.

One important reason for LDCs' difficulties in asserting themselves on the world market is their lack of diversification of exports. Most LDCs are currently as dependent on one or two raw materials as they were ten, twenty or forty years ago. For most of these products, demand and price developments have been weak for a long period of time; the commodities which dominate LDC exports belong to the stagnating rather than the dynamic segment of world trade.

The structural adjustment programmes which most LDCs, especially those located in Africa, have implemented in a more or less wholehearted fashion since the 1980s, have not managed to reverse the negative trend as concerns economic growth and social development. Nothing can be said with certainty, of course, about how developments would have been without these programmes however most observers would today agree with the assessment that while the programmes may have been successful in reducing inflation and fiscal deficits, they failed to reach their main development objectives, at least in the African LDCs. The past decades' strong emphasis on poverty reduction and the formulation of poverty reduction strategies (PRSS) is a welcome development, but domestic ownership of the new generation of development strategies remains weak in LDCS as a whole.

16.1.2 Globalisation's opportunities – and risks

Globalisation means that the world is shrinking, and decreasing costs of international transport and communications have created major opportunities for everyone, including LDCS, to find new markets and niches on a dynamic world market.

This study has underlined how much the poorest countries of the world have to gain from increased foreign trade, and has examined the dynamic effects that trade can exert on the economic development of a country: trade increases access to imported inputs and capital goods, trade can introduce new technology and know-how, new ideas and international contacts, trade makes it possible to exploit economies of scale even in countries with very limited domestic markets, etc.

At the same time it must be emphasised that increased integration with the world market does not automatically lead to increased welfare. The benefits generated by increased trade can be distributed very unevenly throughout the country, and there are also risks – of unemployment, destruction of domestic agricultural and industrial production due to competition from imports, increased vulnerability, decreased food security, exhaustion of natural resources etc. – all of which must be considered in the development strategies of the world's poorest countries.

Agriculture provides a very clear example. As this sector employs the majority of the populations of LDCS, its importance to food security and opportunities to alleviate poverty is decisive. At the same time the extensive agricultural subsidies provided by industrialised countries produce a wide range of foodstuffs at such low prices that no unsubsidised grower can compete. When LDCS liberalised their trade in foodstuffs, cheap food imports decreased incentives for domestic production and sabotaged local markets.

One very general conclusion is that the least developed countries have not benefited much from the various bodies of global trade regulations that are emerging within WTO. Formally, the LDCS are to enjoy a privileged position via the provisions for special and differential treatment stated in many WTO agreements. This special treatment is, however, often only marginal in importance, and most WTO agreements are primarily designed to satisfy the interests of industrialised countries. The Uruguay Round forced the LDCS, after transitional periods which will soon expire, into a series of domestic policy reforms to which the countries themselves had not given priority.

As regards market access, the industrialised countries' specific import regulations are, however, more important for LDC exports than WTO regulations. All industrialised countries apply systems of tariff reductions for developing countries, and the EU decision from 2001 to dismantle virtually all tariffs and import quotas on goods from LDCs is very satisfactory. However, a real improvement of market access for LDC exports of industrial products will not occur until the rules of origin applied are liberalised and the various threats in the form of safeguards and anti-dumping measures are abolished.

16.2 Proposals and recommendations

As indicated many times in this study we do not believe that the only, or even the most important, constraints on economic and social development in LDCs are of external character, i.e. related to the global economy or the trade policies of the richer countries. The greatest and most decisive development constraints are connected to the poverty of these countries, i.e. the low educational level of their populations, weak institutions, deficient physical infrastructure, sometimes also corruption, mismanagement and abuse of power – the list is long, and some of the most serious problems have been discussed previously.

In the concluding recommendations which follow, we have abstained from making proposals to the LDCs themselves. The situations of the 50 countries which comprise the LDC group vary enormously and it is not meaningful to provide "good advice" which is of interest to all LDCs. Neither do we regard this as the task of this study, which emphasises external factors, primarily the international trading system and its regulatory framework.

It should also be stressed that our general recommendations are based on what we consider to be most important to the poorest countries. We are fully aware that the governments of industrial countries also have their own national interests to consider.

16.2.1 LDCs and WTO

LDC participation in the World Trade Organisation, WTO, and in the global body of regulations within the trade area which is under establishment is still rather marginal, although great advances in knowledge and willingness to participate in an active manner have been made in recent years. However, over one third of LDCs are not members of WTO, and the majority participate only sporadically in WTO's trade policy negotiations.

One cause of this limited involvement in WTO is lack of resources, primarily in the form of trade policy expertise. The richer countries possess an enormous advantage in this respect. In order to decrease the disadvantages of the poorer countries we recommend:

- support for institutional reforms within WTO which would increase the practical influence of poorer countries over the WTO decision-making and negotiating processes;
- in order to encourage and facilitate the inclusion of new LDC members of the WTO, the accession process should be speeded up with the help of less demanding and more transparent accession procedures for low-income countries;
- substantially increased – but demand-driven rather than compliance-oriented – ODA to strengthen LDC trade policy capacity, negotiating strength and trade-related physical and institutional infrastructure;
- the introduction of some form of legal assistance or *ombuds* office able to monitor the interests of LDCs in cases where other countries violate LDCs' rights and the LDCs themselves do not possess sufficient resources to manage the dispute settlement process.

A large part of this study has covered the various WTO agreements. One conclusion is that even if LDCs have been granted a series of exemptions and special regulations – primarily in the form of extended transition periods for implementation of agreements – their special conditions and development needs have not always been sufficiently taken into consideration.

- The principles of non-reciprocity and special benefits for developing countries generally and LDCs in particular should be retained. All agreements should pay special attention to LDCs' development efforts. Much more is required than the ad hoc exemptions which have previously formed the WTO's *"special and differential treatment"*.

The opportunities the WTO agreements provide for the industrialised countries to apply protectionist measures aimed at the exports of developing countries form a latent threat which may counteract any advantages gained from improved market access. This applies not least to anti-dumping regulations. Although no LDC has, to date, been involved in a formal dispute concerning dumping, there is always a risk that this will happen if an LDC should become extremely successful on a certain export market.

We therefore recommend:

- a ban on anti-dumping measures aimed at LDCs, and a more restrictive application of the anti-dumping clause against developing countries in general and against the relatively economically weak developing countries outside the LDC group in particular. In addition, the middle-income developing countries should be restrictive in their utilisation of the anti-dumping instrument against the economically weaker developing countries and, of course, against the LDCs.
- a ban on industrialised country invocation of the Safeguard Clauses against LDCs, while use of safeguards by the LDCs should be accepted.

In the WTO Agreement on Agriculture, it is the producers in the richer rather than the poorer countries who enjoy special benefits. This agreement appears to be considerably imbalanced as it has not led to a decrease of industrialised countries' subsidies at the same time as it has limited LDCs' opportunities of protecting their markets. We therefore recommend:

- a successive but unconditional dismantling of industrial countries' trade-distorting agricultural subsidies and a decrease of their import barriers;
- improved opportunities for LDCs to support agricultural production and to protect their domestic markets for foodstuffs – for example through the proposed SSM and SP mechanisms (see Chapter 10.6.5) – at least as long as industrialised countries continue to dump their surplus agricultural products on the world market;
- a drastic increase in the share of ODA going to rural development and agriculture.

Several of the WTO agreements – such as TRIPS which regulates intellectual property issues, TRIMS which covers investment issues and GATS which deals with services – are poorly adapted to the needs of LDCs. We therefore recommend:

- that LDCs be entitled to increased flexibility as concerns opting out of parts of the agreements and regulations (such as TRIPS, TRIMS or GATS, or parts of the agriculture agreement).

LDCs should have the right to decide for themselves when to implement the various parts of the agreements;
- that, in future WTO negotiations, LDCs should be entitled to decide for themselves which parts of the negotiated results they wish to implement, i.e. an exemption from the "single undertaking" requirement.
- that detailed impact assessments of GATS from a development perspective should be carried out covering the effects this agreement would have on LDCs.

The implementation of the various trade policy agreements is connected to enormous costs for developing countries. Agreements do not merely cover decreasing tariffs and other trade barriers, they also imply the reform– or sometimes building up from scratch – of national legislation and exercise of governmental authority such as the changes necessary in the case of the TRIPS Agreement and the Agreement on Tariff Valuation. Many LDCs therefore choose – often rightly in our judgement – to invest their scarce resources in other, more urgent, areas. We therefore recommend:

- that LDCs' direct costs for implementation of the Uruguay Round agreements and later WTO agreements be reduced by the allocation of substantially increased financial and technical assistance.

As concerns the demands made by EU among others regarding a new, broader round of negotiations within WTO in which new issues such as competition law and investment regulations are to be included, we do not consider such an enlargement of the WTO agenda in a new round to be in the interests of LDCs at present.

16.2.2 Trade barriers and bilateral preference agreements

The LDCs' inadequate involvement in WTO is to a large extent due to the fact that their development problems have more to do with supply constraints than with issues related to market access. However they are also negatively affected by many of the trade barriers still remaining on the markets of other countries which are more connected to the trade policies of these countries than WTO regulations.

The LDCs are negatively affected by a series of protectionistic elements in trade policies operated by the richer industrialised countries and other developing countries. One of the most serious is the tariff peaks, i.e. extra high tariffs on certain products, many of which are of special interest to several LDCs. Another extremely destructive measure is tariff escalation i.e. tariffs which increase with the degree of processing of the product which therefore facilitates continued exports of raw materials and makes it more difficult to export finished or semi-finished goods with higher value added.

In the textiles/clothes area, remaining tariffs on many markets pose a serious problem for LDCs, as do the rules of origin which impose conditions on LDCs textiles products if they are to receive preferential access. LDCs meet no quantitative restrictions, and they have, in theory, duty-free access to the important EU market, but are severely affected by the rules of origin regulations as their industrial base is too small to manage the criteria set by industrialised countries for freedom from tariffs. LDCs cannot, for example, process cheap yarn and cloth from China in their domestic textiles industry and then export the finished garments to the industrialised countries and still retain their duty-free status.

The majority of the LDCs, including those who are members of WTO, are also members of various bilateral trade preference agreements which are normally much more important for their market access than WTO.

The recent EU decision mentioned earlier to grant freedom from tariffs for all LDCs exports on EU's inner market is, in our opinion, very satisfactory and it would be desirable if all the other industrialised countries could do the same thing. However, requirements concerning rules of origin which seriously hinder cooperation between LDCs and other developing countries are extremely unfortunate. The EU has also retained the right to unilaterally impose protectionist safeguards against imports of certain products if these should threaten important producer interests within the EU.

The new form of economic agreements that are envisaged to replace the Lomé and Cotonou Conventions between the EU and the ACP countries, the so-called Economic Partnership Agreements (EPAs) contain, in our opinion, many questionable elements in particular the lack of a clear development focus which the ACP countries have repeatedly requested. The EU's insistence on the creation of free trade areas and its abandonment of non-reciprocal trade preferences represents a step in the wrong direction.

The attempts by the EU to include a number of new issues – the "Singapore issues" and others which have been rejected by developing countries in WTO negotiations – in the EPAs can also be strongly questioned.

The ACP countries ought to be allowed to maintain a more generous policy space, especially in agriculture, where tariff protection against the dumping of food surpluses from the EU and other OECD countries should be permitted.

An EU decision following EPA agreements to grant duty-free and quota-free access to the inner market for all ACP countries would erode the preferential treatment enjoyed by the LDCs as a consequence of the EBA initiative. This is, however, a minor disadvantage compared to the potential benefits for the ACP countries, many of which are as poor as the LDCs without, however, being classified as least developed.

On the basis of the conclusions listed above and other observations we wish to recommend:

- duty-free and quota-free market access for all LDC products to all OECD countries, and the maintenance of non-reciprocal trade preferences for developing countries;
- a strong emphasis on development rather than free trade objectives in the EU's future agreements with the ACP countries, and a rejection of the EU's attempts to include issues in the EPAs which developing countries have opposed in the WTO negotiations;
- more generous and harmonised rules of origin for LDCs and expanded origin cumulation as concerns other developing countries;
- successive phasing out of industrialised countries' trade-distorting agricultural subsidies;
- extended opportunities for origin cumulation in the textiles area so that LDCs can process textiles from other countries, including China;
- successive reduction of industrialised countries' tariff escalation and remaining tariff peaks vis-à-vis developing countries.

Appendix 1

The Least Developed Countries: basic data

Population (millions)	Economy	GDP per capita (dollars)	Year of LDC status	Year of WTO membership or present status
139	Bangladesh	443	1975	1995
76	Ethiopia	106	1971	process of accession
56	Dem. Rep. of the Congo	115	1998	1997
50	Myanmar	219	1987	1995
38	Tanzania	288	1971	1995
36	Sudan	562	1971	process of accession
29	Afghanistan	184	1971	not a member
28	Uganda	280	1971	1995
27	Nepal	245	1971	2004
20	Yemen	643	1975	process of accession
19	Mozambique	328	1988	1995
18	Madagascar	222	1991	1995
15	Angola	1.309	1994	1996
14	Cambodia	316	1991	2004
13	Niger	199	1971	1996
13	Mali	377	1971	1995
13	Burkina Faso	348	1998	1995
13	Malawi	165	1971	1995
11	Zambia	463	1991	1995
11	Senegal	672	2000	1995
9	Chad	426	1971	1996
9	Guinea	421	1971	1995
9	Rwanda	205	1971	1996
8	Haiti	471	1971	1996
8	Benin	500	1971	1996
8	Somalia	262	1971	not a member
7	Burundi	93	1971	1995

6	Togo	348	1982	1995
6	Lao People's Dem. Rep.	419	1971	process of accession
5	Sierra Leone	196	1982	1995
4	Eritrea	187	1994	not a member
4	Central African Republic	330	1975	1995
3	Liberia	146	1990	not a member
3	Mauritania	416	1986	1995
2	Bhutan	368	1971	process of accession
2	Lesotho	764	1971	1995
2	Guinea-Bissau	176	1981	1995
1,5	Gambia	281	1975	1996
0,9	Timor Leste	550		not a member
0,8	Djibouti	852	1982	1995
0,8	Comoros	427	1977	not a member
0,5	Cape Verde	1.947	1982	observer
0,5	Equatorial Guinea	7.845	1977	process of accession
0,5	Solomon Islands	585	1991	1996
0,3	Maldives	2.345	1971	1995
0,2	Vanuatu	1.405	1985	process of accession
0,2	Samoa	1.968	1971	process of accession
0,2	Sao Tome and Principe	447	1982	observer
0,1	Kiribati	815	1986	not a member
0,01	Tuvalu	2.141	1986	not a member

Source: www.unctad.org Handbook of Statistics, and www.wto.org

Appendix 2

LDC exports and external debt in 2004

LDC	Total exports (MUSD, 2004)	External debt (MUSD, 2004)	Main export sectors	Share (%) of total exports
Afghanistan	179.2	440	Carpets and rugs	47
Angola	10 847.5	9521	Petroleum. crude	88
Bangladesh	7 946.2	20344	Garments	66
Benin	371.9	1916	Cotton yarn	31
Bhutan	175	593	Electricity	48
Burkina Faso	387.1	1967	Cotton. Raw	47
Burundi	53.2	1385	Coffee	47
Cambodia	2555.3	3377	Garments	60
Cape Verde	20.3	517	Air transport services	44
Central African Republic	127.4	1078	Wood products	33
Chad	990.9	1701	Livestock	30
Comoros	35.8	306	Tourism	41
Congo. Dem Rep	1260.2	11841	Diamonds	52
Djibouti	249.1	429	Government services	76
Equatorial Guinea	3186.2	291	Petroleum. crude	91
Eritrea	50	681	Tourism	31
Ethiopia	766.9	6574	Air transport services	22
Gambia. The	37.2	674	Tourism	53
Guinea	955.4	3538	Bauxite and alumina	51
Guinea-Bissau	110.1	765	Cashew nuts	85
Haiti	423.3	1225	Clothing and apparel	56
Kiribati	17.4	15	Licence fees/royalties	50
Lao PDR	564.6	2056	Tourism	22
Lesotho	595	764	Clothing	68
Liberia	693.5	2706	Logs and timber	54
Madagascar	1265.8	3462	Textiles and clothing	27

Malawi	482.1	3418	Tobacco	52
Maldives	203	345	Tourism	73
Mali	318.1	3316	Gold	55
Mauritania	793.4	2297	Iron ore	50
Mozambique	1342.6	4651	Alumina	41
Myanmar	3217.7	7239	Garments	28
Nepal	656.1	3354	Garments	24
Niger	280.5	1950	Uranium	29
Rwanda	208.3	1656	Niobium and tantalum	23
Samoa	106	562	Tourism	55
Sao Tome and Principe	10.1	362	Tourism	55
Senegal	1385.6	3938	Fish and other fish products	20
Sierra Leone	180.4	1723	Diamonds	53
Solomon Islands	174.3	176	Timber products	38
Somalia	198.2	2849	Goats and sheep	57
Sudan	4136.4	19332	Petroleum. crude	71
Tanzania	1295.8	7800	Tourism	43
Timor Leste	na	na	na	na
Togo	550	1812	Cement	24
Tuvalu	1.9	na	Tourism	35
Uganda	740.8	4822	Tourism	23
Vanuatu	210.2	118	Tourism	28
Yemen. Rep	4628.6	5488	Petroleum. crude	80
Zambia	1198.1	7279	Copper. refined	45

Source: UNCTAD Handbook of Statistics, www.unctad.org and (foreign debt) OECD, www.oecd.org

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Glossary: Explanations and abbreviations

ACP countries	79 developing nations in Africa, the West Indies and the Pacific Ocean who are signatories to the Cotonou Agreement with the EU
ACWL	Advisory Centre on WTO Law. An ODA financed centre based in Geneva providing legal advice to developing countries
AFT (A4T)	Aid for Trade
AGOA	African Growth and Opportunity Act (providing preferential access to the US market)
AIDS	Acquired Immune Deficiency Syndrome
Amber support	Agricultural support that the WTO deems to be trade distorting
AMU	Arab Mahgreb Union
APEC	Asia-Pacific Economic Cooperation. Members include both industrialised and developing countries along the Pacific Rim
ASEAN	Association of Southeast Asian Nations. Forum for economic and political cooperation for countries in Southeast Asia
ATC	Agreement on Textiles and Clothing. Part of the Uruguay Round
BIMST-EC	Bangladesh-India-Myanmar-Sri Lanka- Thailand Economic Cooperation

Blue support	Agricultural support exempted from the requirement to decrease production in the WTO Agriculture Agreement
Bound tariffs	Tariffs which a member country of the WTO has promised not to exceed. Bound tariffs therefore represent a ceiling; actually tariffs applied are often much lower.
CACM	Central American Common Market
CAFTA-DR	Central American and Dominican Republic Free Trade Association. Free Trade agreement between the United States and Central America and the Dominican Republic (still not ratified by all member states)
The Cairns Group	Group of 17 agriculture exporting countries lobbying for freer trade in agricultural products under WTO rules
CAP	Common Agricultural Policy. The EU agricultural policy
CARICOM	Caribbean Community and Common Market
Cash crops	Crop grown for sale rather than subsistence (e.g. coffee)
COMESA	Common Market for East and Southern Africa. Regional trading bloc established in 1994
Cotonou Agreement	Partnership agreement signed in June 2000 between the EU and the ACP countries
CRC	UN Convention on the Rights of the Child
Cross-compliance	The right a country has to punish a country that breaks WTO rules by implementing sanctions on a sector other than the one involved in the original dispute

Cumulation	A system of rules of origin which enables product processing (origin cumulation) in two or more countries without losing preferential tariffs
De minimis rule	Regulation in WTO Agriculture Agreement that specifies that product-specific amber farming support less than under 5% of production value is exempted from demands to reduce tariffs
DDA	Doha Development Agenda
EAC	East African Community. (Kenya, Tanzania and Uganda. Burundi and Rwanda are expected to join in 2007)
EBA	Everything but arms (LDC preferences on the EU market)
ECOWAS	Economic Community of West African States
EDF	European Development Funds, EU's development funds
Enabling clause	Clause in GATT that enables developing countries to receive special treatment e.g. through tariff relief that breaches the most favoured nation principle
EPA	Economic Partnership Agreement. Trade and co-operation agreements currently being negotiated between the EU and ACP countries
EPZ	Export Processing Zone, geographical free zone where foreign corporations can set up companies to export from the host nation
ESAMI	Eastern and Southern Africa Management Institute (located in Arusha, Tanzania)
ESCAP	Economic and Social Commission for Asia and the Pacific

EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Area
	Also: Foreign Trade Association (private sector agency with headquarters in Brussels)
FTAA	Free Trade Area of the Americas, embryonic plan to create an American free trade area (excluding Cuba)
GATS	General Agreement on Trade in Services.
GATT	General Agreement on Tariffs and Trade. Predecessor to WTO established in 1947
GDP	Gross Domestic Product
GCC	Gulf Cooperation Council. Embryonic free trade area for six states in the Arabian Gulf
GNI	Gross National Income
GPA	Government Procurement Agreement
Green support	Agricultural support which is considered in WTO's Agricultural Agreement not to exercise an (excessively) distorting effect on trade
GSP	Generalised System of Preferences (for developing countries)
GSTP	Global System of Trade Preferences. A system for tariff reduction and trade liberalisation between developing countries
G6	Informal WTO group comprising the USA, EU, Japan, Australia, Brazil and India

G7	Group of seven leading OECD countries
G8	G7 plus Russia
G10	Group of net food importers with heavily protected agricultural sectors including Japan, Switzerland, South Korea and Norway
G20	Negotiating group (formed at the WTO meeting in Cancún) of developing countries
G33	Group of around 40 developing countries particularly concerned about food and livelihood security
G77	Developing country group at the UN
G90	Group of 90+ developing countries, including the African Group and all ACP countries and LDCs
G110	A "grand coalition" of developing countries (formed at the Hong Kong Ministerial Conference in 2005) consisting of the G20, G33, G90, the African Group, the ACP Group and all LDCs
HDI	Human Development Index
HIPC	Initiative to ease the debt burden of the Highly Indebted Poor Countries
HIV	Human Immuno-deficiency Virus
ICT	Information and Communication Technology
ICTSD	International Centre for Trade and Sustainable Development. NGO based in Geneva
IF	Integrated Framework for trade-related assistance to LDCs (supported by WTO, IMF, ITC, UNCTAD, UNDP and the World Bank)

IFOAM	International Federation of Organic Agricultural Movements
ILO	International Labour Organisation
IMF	International Monetary Fund
IPPC	International Plant Protection Convention
ISO	International Standardisation Organisation
IT/ICT	Information (and Communication) Technology
ITC	International Trade Centre based in Geneva
JITAP	Joint Integrated Technical Assistance Programme. A programme of trade-related technical assistance administered by the WTO, ITC and UNCTAD
LDC	Least Developed Country
The Lomé Convention	The predecessor to the Cotonou Agreement between the EU and ACP countries
MAI	Multilateral Agreement on Investment. Developed by the OECD but withdrawn in 1999 following extensive criticism
MERCOSUR	Free trade area in South America (Argentina, Brazil, Paraguay and Uruguay, recently joined by Venezuela))
MFA	Multi-fibre Agreement. Complicated system (scrapped in 2005) for protecting textile industries in the industrialised world with the help of import quotas and other quantitative restrictions
MFN	Most-Favoured Nation. Important trade policy principle within GATT and WTO stating that every trade benefit a country grants to another country must also be offered to every other country who is a WTO member

Multi-functionality	A principle floated by industrialised countries meaning that in addition to producing agricultural goods, the farming sector also plays an important role in other areas such as biodiversity, environmental protection and animal conservation
NAFTA	North American Free Trade Agreement (USA, Canada and Mexico)
NAMA	Non-agricultural Market Access
National treatment (NT)	Important GATT principle that aims to guarantee that imported products are not discriminated against in relation to domestic production
NFIDC	Net Food-importing Developing Countries
NGO	Non-governmental organisation
Non-reciprocity	The principle that developing countries do not have to make as large-scale commitments in WTO as industrialised countries. Deviation from most favoured nation principle that enables developing countries to be given special preferential trading terms without demands for reciprocity
Non-tariff trade barriers	Measures other than tariffs to restrict imports or to make importing more difficult
ODA	Overseas Development Assistance (foreign aid)
OECD	Organisation for Economic Cooperation and Development
Paris Club	Informal forum where bilateral debt relief is negotiated between debtor and creditor countries
PARTA	Pacific Regional Trade Agreement
Peak tariffs	Tariffs that exceed 12% (UNCTAD definition)

PPP	Purchasing Power Parity
PRS(P)	Poverty Reduction Strategy (Papers). Since 1999, the World Bank has sought to persuade developing countries to establish poverty reduction strategies based on PRSPS
PSI	Pre-Shipment Inspection, WTO rules on pre export inspections
PTA	Preferential Trade Agreement. An agreement involving tariff reductions on trade between two or more countries
Rent seeking	Attempts to exploit restrictions, bureaucratic regulations, trade regulations such as import controls, licenses etc in order to earn money/gain advantage
Rules of Origin	Laws and rules applied to determine the country of origin for exports. The origin determines whether or not the goods are eligible for preferential import treatment
SAARC	South Asian Association of Regional Cooperation
SACU	Southern African Customs Union made up of Botswana, Lesotho, Namibia, Swaziland and South Africa
SADC	Southern African Development Community. Presently 14 members
Safeguard Clauses	Permit countries to introduce specific protective tariffs if import prices fall or import volumes rise above a certain level
Sanitary measures	Measures to protect the lives and health of people and animals

S&D or SDT	Special and differential treatment. Rules on exemptions, e.g. longer transition times for developing nations to meet WTO rules and regulations
Sida	Swedish International Development Cooperation Agency
Singapore issues	Proposals by OECD countries to include four new issues – competition, investment, transparency in government procurement and trade facilitation – in the Doha Round of trade negotiations
Single undertaking	Requirement that WTO members accept agreements in their entirety rather than a la carte
SP	Special Products, in WTO negotiations usually referring to particularly sensitive agricultural products
SPS Agreement	WTO agreement on sanitary and phytosanitary measures. Measures designed to protect the health of humans, animals and vegetation
SSM	Special Safeguard Mechanism. A G33 proposal to allow developing countries to put in place high levels of agricultural product tariffs to protect themselves from import surges or a collapse of import prices
STABEX	Fund established under the Lomé Conventions aimed at stabilising agricultural export earnings from the ACP countries. Eliminated in the Cotonou Agreement
SYSMIN	Fund established under the Lomé Conventions aimed at stabilising mineral export earnings from the ACP countries. Eliminated in the Cotonou Agreement

Tariff escalation	A tariff structure in which protection rises with the degree of processing. Consequently finished goods pay higher tariffs than semi-finished products and semi-finished higher than raw materials
TBT Agreement	WTO Agreement on Technical Barriers to Trade
TNC	Transnational Corporation
TMB	Textile Monitoring Body. International organisation monitoring trade in textiles
TPRM	WTO Trade Policy Review Mechanism. Periodical examination of the trade policies of WTO member countries
TRAPCA	Trade Policy Training Centre in Africa (located in Arusha, Tanzania)
TRIMS	Trade-Related Investment Measures, WTO agreement on investment rules
TRIPS	Trade-Related Aspects of Intellectual Property Rights, WTO agreement covering copyrights, patents etc.
UEMOA	Union Economique et Monétaire Ouest-Africaine, organisation consisting of former French colonies in West Africa
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UPOV	Union for the Protection of New Varieties of Plants
USD	US Dollar

VAT	Value-added Tax
VER	Voluntary Export Restrictions. Not very voluntary quotas that used to restrict imports, mainly of textile goods, to industrialised country markets
WIPO	World Intellectual Property Organisation. UN body based in Geneva which monitors issues of intellectual property rights
WTO	World Trade Organisation
WWF	World Wide Fund for Nature

Notes on the Author

Associate Professor STEFAN DE VYLDER is a Swedish economist who is presently working as an independent researcher and consultant. His more recently published books include "The impact of HIV/AIDS on livelihoods, poverty and the economy of Malawi" (2006, co-authors Lisa Arrehag, Dick Durevall and Mirja Sjöblom), "Ending Gender-based Violence" (2004, with several co-authors), "The Driving Forces of Development. On Poverty, Wealth and Justice in the World" (2002, in Swedish), "The Least Developed Countries and World Trade" (2001, co-authors Gunnel Axelsson-Nycander and Marianne Laanatza), "Macroeconomic Policies and Children's Rights" (2000) and "From Plan to Market. The Economic Transition in Vietnam" (1996, jointly with Adam Fforde). As a consultant, his activities during the last few years have covered social and economic consequences of HIV/AIDS, gender equality, rural development and trade and globalisation issues.

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This is a revised version of Sida Studies no. 5, of the same title, published in 2001, written by Stefan de Vylder, Gunnel Axelsson Nycander and Marianne Laanatza.

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